CENTRAL BANK OF BOSNIA AND HERZEGOVINA

INDEPENDENT AUDITOR'S REPORT
AND FINANCIAL STATEMENTS
FOR THE YEAR ENDED
31 DECEMBER 2019

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Responsibility of the Management and the Governing Board for the preparation and approval of the annual financial statements

The Management is required to prepare financial statements for each financial year which give a true and fair view of the financial position of the Central Bank of Bosnia and Herzegovina and of the results of its operations and cash flows, in accordance with International Financial Reporting Standards, as published by the International Accounting Standards Board. The Management is responsible for maintaining proper accounting records to enable the preparation of such financial statements at any time. The Management has a general responsibility for taking such steps as are reasonably available to it to safeguard the assets of the Central Bank of Bosnia and Herzegovina and to prevent and detect fraud and other irregularities.

The Governing Board is responsible for selecting suitable accounting policies to conform to applicable International Financial Reporting Standards and the Management is responsible for their consistent application, making judgements and estimates that are reasonable and prudent and for preparing the financial statements on a going concern basis.

The Management is responsible for the submission to the Governing Board of its annual financial statements, following which the Governing Board is required to approve the annual financial statements for submission to the Parliamentary Assembly of Bosnia and Herzegovina.

The accompanying financial statements set out on pages 5 to 69 were approved by the Governing Board on 30 March 2020 and are signed, on its behalf by:

Senad Softić, Ph.D.
Chairman of the Governing Board

Edis Kovačević, M.Sc.

Head of Accounting and Finance Department

Grant Thornton

Independent Auditor's Report

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To the Governing Board of the Central Bank of Bosnia and Herzegovina

Opinion

We have audited the accompanying financial statements of the Central Bank of Bosnia and Herzegovina (hereinafter: the "Central Bank"), which comprise the Statement of financial position as at 31 December 2019 and the Statement of profit or loss, Statement of comprehensive income, Statement of changes in equity and Statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Central Bank as at 31 December 2019, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (hereinafter: "ISAs"). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Central Bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the financial statements of the Central Bank, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of the Management and the Governing Board of the Central Bank for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards, and for such internal control as the Management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Management is responsible for assessing the Central Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting.

The Governing Board of the Central Bank is responsible for overseeing the Central Bank's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but it is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from a fraud is higher, than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Central Bank's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management.

- Conclude on the appropriateness of the Management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Central Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Central Bank to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the Governing Board of the Central Bank regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Aleksandar Džombić, PhD

Director

Grant Thornton d.o.o.

Banja Luka, 30 March 2020

Nevena Milinković

Certified Auditor

Grant Thornton d.o.o.

Banja Luka, 30 March 2020

Suzana Stavrikj, Partner

Grant Thornton d.o.o.

Skopje, 30 March 2020

Kledian Kodra, Partner

Grant Thornton sh.p.k.

Tirana, 30 March 2020

STATEMENT OF PROFIT OR LOSS

In thousands of KM	Note	For the year ended 31 December 2019	2018
Interest income		51,178	48,186
Interest expense		(26,358)	(24,393)
NET INTEREST INCOME	4	24,820	23,793
Fee and commission income		17,665	17,209
Fee and commission expenses		(653)	(636)
NET FEE AND COMMISSION INCOME	5	17,012	16,573
Net realised gains from sale of debt instruments at fair value through other comprehensive income	6	238	4,277
Net foreign exchange gains	7	267	151
Other income	8	895	1,522
OPERATING INCOME		43,232	46,316
Personnel expenses	9	(19,670)	(19,034)
Administrative and other operating expenses	10	(7,950)	(8,250)
Depreciation and amortisation charge	17	(2,446)	(2,426)
OPERATING EXPENSES		(30,066)	(29,710)
FINANCIAL RESULT BEFORE PROVISIONS FOR EXPECTED CREDIT LOSSES		13,166	16,606
Provisions for expected credit losses, net decrease / (increase)	11	9,409	(8,175)
NET PROFIT FOR THE YEAR		22,575	8,431

The accompanying notes on pages 12 to 69 are an integral part of these financial statements.

STATEMENT OF COMPREHENSIVE INCOME

In thousands of KM	Note	For the year ended 31 December 2019	2018
NET PROFIT FOR THE YEAR		22,575	8,431
Other comprehensive income			
Items that are or may be reclassified subsequently to profit or loss:			
Debt instruments at fair value through other comprehensive income			
Net change in fair value during the year	14	77,863	(6,390)
Net change in provisions for expected credit losses recognized in profit or loss during the year	29.1.1.	(7,598)	7,301
Reclassification to profit or loss from sale of debt instruments	6	(238)	(4,277)
		70,027	(3,366)
Monetary gold			
Net change in fair value during the year	15	44,092	6,138
		44,092	6,138
Total other comprehensive income		114,119	2,772
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		136,694	11,203

The accompanying notes on pages 12 to 69 are an integral part of these financial statements.

STATEMENT OF FINANCIAL POSITION

In thousands of KM	Note	31 December 2019	As at 31 December 2018
ASSETS			
Foreign currency in cash	12	322,599	274,099
Deposits with foreign banks	13	3,102,765	2,911,448
Debt instruments	14	8,917,413	8,225,439
Monetary gold	15	254,088	209,996
Special Drawing Rights with the IMF	26, 31	230	2,236
Other assets	16	11,457	10,554
Property and equipment	17	48,314	44,677
Intangible assets	17	1,563	1,342
Other investments	18	27,813	27,813
TOTAL ASSETS		12,686,242	11,707,604
LIABILITIES AND EQUITY			
LIABILITIES			
Currency in circulation	19	5,199,916	4,750,614
Deposits from banks	20	5,743,619	5,523,290
Deposits from the Government and other public depositors	21	880,675	709,367
Provisions for liabilities and charges	22	1,394	1,259
Other liabilities	23	4,097	3,227
Total liabilities		**11,829,701**	**10,987,757**
EQUITY			
Initial capital		25,000	25,000
Reserves		831,541	694,847
Total equity	24	**856,541**	**719,847**
TOTAL LIABILITIES AND EQUITY		12,686,242	11,707,604

The accompanying notes on pages 12 to 69 are an integral part of these financial statements.

STATEMENT OF CHANGES IN EQUITY

In thousands of KM	Initial capital	General reserves (Retained earnings)	Other reserves	Fair value reserves for debt and equity instruments at fair value through other comprehensive income	Provisions for expected credit losses	Fair value reserves for monetary gold	Total reserves	Total equity
Balance at 1 January 2019	25,000	514,720	31,300	133,696	8,993	6,138	694,847	719,847
Total comprehensive income for the year	-	22,575	-	77,677	(7,650)	44,092	136,694	136,694
Net profit for the year (Note 25)	-	22,575	-	-	-	-	22,575	22,575
Other comprehensive income	-	-	-	77,677	(7,650)	44,092	114,119	114,119
Net unrealised positive changes in fair value for debt instruments	-	-	-	*77,863*	-	-	*77,863*	*77,863*
Net realised positive changes in fair value for debt instruments transferred to profit or loss	-	-	-	*(186)*	-	-	*(186)*	*(186)*
Net release of provisions for expected credit losses for debt instruments recognised in profit or loss	-	-	-	-	*(7,598)*	-	*(7,598)*	*(7,598)*
Net release of provisions for expected credit losses transferred to profit or loss for debt instruments sold	-	-	-	-	*(52)*	-	*(52)*	*(52)*
Net unrealised positive changes in fair value for monetary gold	-	-	-	-	-	*44,092*	*44,092*	*44,092*
Balance at 31 December 2019	25,000	537,295	31,300	211,373	1,343	50,230	831,541	856,541

The accompanying notes on pages 12 to 69 are an integral part of these financial statements.

STATEMENT OF CHANGES IN EQUITY (CONTINUED)

In thousands of KM	Initial capital	General reserves (Retained earnings)	Other reserves	Fair value reserves for debt and equity instruments at fair value through other comprehensive income	Provisions for expected credit losses	Fair value reserves for Available-for-sale financial assets	Fair value reserves for monetary gold	Total reserves	Total equity
As at 31 December 2017 - as stated	25,000	542,766	31,300	-	-	93,120	(39,551)	627,635	652,635
Impact of adopting IFRS 9	-	(36,477)	-	141,765	4,290	(93,120)	39,551	56,009	56,009
As at 1 January 2018 - restated	25,000	506,289	31,300	141,765	4,290	-	-	683,644	708,644
Total comprehensive income for the year	-	8,431	-	(8,069)	4,703	-	6,138	11,203	11,203
Net profit for the year (Note 25)	-	8,431	-	-	-	-	-	8,431	8,431
Other comprehensive income	-	-	-	(8,069)	4,703	-	6,138	2,772	2,772
Net unrealised negative changes in fair value for debt instruments	-	-	-	*(6,390)*	-	-	-	*(6,390)*	*(6,390)*
Net realised positive changes in fair value for debt instruments transferred to profit or loss	-	-	-	*(1,679)*	-	-	-	*(1,679)*	*(1,679)*
Net increase in provisions for expected credit losses for debt instruments recognized in profit or loss	-	-	-	-	*7,301*	-	-	*7,301*	*7,301*
Net release of provisions for expected credit losses transferred to profit or loss for debt instruments sold	-	-	-	-	*(2,598)*	-	-	*(2,598)*	*(2,598)*
Net unrealised positive changes in fair value for monetary gold	-	-	-	-	-	-	*6,138*	*6,138*	*6,138*
Balance at 31 December 2018	25,000	514,720	31,300	133,696	8,993	-	6,138	694,847	719,847

The accompanying notes on pages 12 to 69 are an integral part of these financial statements.

STATEMENT OF CASH FLOWS

In thousands of KM	Note	For the year ended 31 December 2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES			
Net profit for the year		22,575	8,431
Adjusted for:			
Interest income	4	(51,178)	(48,186)
Interest expense	4	26,358	24,393
Provisions for expected credit losses, net (decrease) / increase	11	(9,409)	8,175
Net realised (gains) from sale of debt instruments at fair value through other comprehensive income	6	(238)	(4,277)
Net foreign exchange (gains)	7	(267)	(151)
Income from grants	8	(98)	(144)
Provisions for liabilities and charges, net increase / (decrease)	9, 22	277	(222)
Net loss / (gain) on disposal of property and equipment		8	(3)
Dividend income recognized in profit or loss	8	(623)	(589)
Depreciation and amortisation charge	17	2,446	2,426
Net cash flows from operating activities before changes in operating assets and liabilities		(10,149)	(10,147)
Changes in operating assets and liabilities			
Decrease / (increase) in term deposits with foreign banks		584,828	(640,581)
(Increase) in debt instruments		(614,111)	(757,972)
(Increase) / decrease in other assets		(882)	1,214
Increase in currency in circulation		449,302	431,254
Increase in deposits from banks, Government and other public depositors		392,941	575,397
Increase / (decrease) in other liabilities		938	(566)
Payments from provisions for liabilities and charges	22	(142)	(169)
Interest received		49,875	47,672
Interest paid		(25,586)	(22,250)
Net cash from operating activities		827,014	(376,148)
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from sale of property and equipment		-	5
Purchases of property, equipment and intangible assets		(6,311)	(1,910)
Dividends received		623	589
Net cash used in investing activities		(5,688)	(1,316)

STATEMENT OF CASH FLOWS (CONTINUED)

In thousands of KM	Note	For the year ended 31 December 2019	2018
CASH FLOWS FROM FINANCING ACTIVITIES			
Distribution of profit to the state budget		-	(7,311)
Net cash used in financing activities		-	(7,311)
Effect from changes in impairment for expected credit losses on cash and cash equivalents		990	(336)
Effects of exchange rate fluctuations on cash and cash equivalents held		296	187
Net increase / (decrease) in cash and cash equivalents		822,612	(384,924)
Cash and cash equivalents at 1 January		1,676,360	2,061,284
Cash and cash equivalents at 31 December	26	2,498,972	1,676,360

The accompanying notes on pages 12 to 69 are an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

1. GENERAL INFORMATION

The Central Bank of Bosnia and Herzegovina (the "Central Bank") is the supreme monetary authority of Bosnia and Herzegovina state ("BH"). Its status has been defined by the Law on the Central Bank of Bosnia and Herzegovina (the "Law on the Central Bank"), adopted by the Parliamentary Assembly of Bosnia and Herzegovina on 20 June 1997, according to the General Framework Peace Agreement in Bosnia and Herzegovina.

The Central Bank started its operations on 11 August 1997.

The Central Bank operates through its Head Office, three main units located in Sarajevo, Mostar, and Banja Luka, and two branches, one in Brčko and other in Pale, the latter of which operates under the authorisation of the main unit in Banja Luka.

Head Office of the Central Bank is located in Sarajevo, Maršala Tita Street, No. 25.

The main objective of the Central Bank is to achieve and maintain the stability of the domestic currency by issuing it to the rule known as a currency board. The currency board rule, required by the Law on the Central Bank, implies that the domestic currency may be issued only with full coverage in convertible foreign currency assets. Nevertheless, the Central Bank has an obligation to purchase and sell Convertible Mark (KM) for Euro (EUR) on demand, without any restrictions, within the territory of BH, at the official exchange rate of KM EUR as KM 1.95583 = EUR 1, prescribed by the Law on the Central Bank.

The tasks performed by the Central Bank as provided by the Law on the Central Bank include:

- determining, adopting and controlling the monetary policy of BH by issuing the domestic currency at the prescribed exchange rate with the full coverage in convertible foreign currency assets;
- holding and managing the official foreign currency reserves of the Central Bank in a safe and profitable manner;
- establishing and maintaing adequate payment and settlement systems;
- issuing provisions and guidelines for the performance of the Central Bank's operations, in accordance with the Law on the Central Bank;
- coordinating the activities of the banking agencies, which are in charge of issuing banking licences and supervising banks in the entitites;
- receiving deposits from the state and public institutions of BH and from commercial banks to fullfill their required reserve obligations;
- putting and withdrawing from circulation the domestic currency, including legal tender banknotes and coins, adhering strictly to the currency board rule;
- taking part in the operations of international organisations working on strengthening the financial and economic stability of the country;
- representing BH in international organisations regarding monetary policy issues.

Within the limits of its authority prescribed by the Law on the Central Bank, the Central Bank is entirely independent from the entities, public agencies and any other authority in the pursuit of its objective and tasks.

1. GENERAL INFORMATION (CONTINUED)

The highest body of the Central Bank is the Governing Board, which is in charge of defining monetary policy and the control of its implementation, and the organisation and the strategy of the Central Bank in accordance with the Law on the Central Bank.

The Management of the Central Bank consists of the Governor and Vicegovernors, appointed by the Governor with the approval of the Governing Board. The Management operationally manages the Central Bank's activities.

According to the Law on the Central Bank, all powers that are not specifically reserved for the Governing Board are vested in the Governor.

The Central Bank has established the Audit Committee consisting of three independent members appointed by the Governing Board. The Audit Committee is in charge of overseeing financial reporting of the Central Bank, monitoring the external audit process of annual financial statements and overseeing the election process of the Central Bank's independent auditors. Due to monitoring and maintaining appropriate risk management framework in the Central Bank, the Audit Committee also evaluates adequacy and efficiency of internal controls and procedures as a risk management instrument as well as the functions of internal audit.

During the course of 2018 and 2019 and up to the date of this report, the Governing Board, the Management and the Audit Committee members are:

Governing Board

Senad Softić Ph.D.	Chairman
Ankica Kolobarić M.Sc.	Member
Šerif Isović M.Sc.	Member
Trivo Marinković M.Sc.	Member (until 19 June 2019 and from 19 July 2019 until 4 October 2019)
Ljubiša Vladušić Ph.D.	Member (until 19 June 2019 and from 19 July 2019 until 4 October 2019)

Management

Senad Softić Ph.D.	Governor
Ernadina Bajrović M.Sc.	Vicegovernor
Milica Lakić Ph.D.	Vicegovernor
Želimira Raspudić	Vicegovernor

Audit Committee

Ph.D Elvir Čizmić	Member (from 1 September 2018)
Ph.D Sead Kreso	Member (until 31 August 2018)
Ph.D Mila Gadžić	Member
Radomir Repija	Member

2. BASIS OF PREPARATION

2.1. Statement of compliance

The financial statements of the Central Bank have been prepared in accordance with International Financial Reporting Standards ("IFRS") as published by the International Accounting Standards Board ("IASB").

2.2. Basis of measurement

These financial statements have been prepared on a historical cost, except for the following material items:

Item	Basis of measurement
Financial assets at fair value through other comprehensive income	Fair value
Monetary gold	Fair value

2.3. Functional and presentational currency

The Central Bank's financial statements are stated in the official national currency of BH which is the KM. All financial information has been rounded to the nearest thousand (unless otherwise stated).

2.4. Standards, interpretations and amendments to published standards that are effective in the current period

The following standards, amendments to the existing standards and interpretations issued by the IASB are effective for the current period:

- IFRS 16: "Leases" (effective for annual periods beginning on or after 1 January 2019),
- IFRIC 23: "Uncertainty over tax treatments" (effective for annual periods beginning on or after 1 January 2019),
- Amendments to IFRS 9: "Financial instruments - Prepayment Features with negative compensation (effective for annual periods beginning on or after 1 January 2019),
- Amendments to IAS 28: "Investments in Associates and Joint Ventures – Long-term interests in associates and Joint Ventures" (effective for annual periods beginning on or after 1 January 2019),
- Annual improvements to IFRS standards 2015-2017 Cycle (effective for annual periods beginning on or after 1 January 2019),
- Amendments to IAS 19: "Employee benefits – Plan amendments, curtailment or settlement" (effective for annual periods beginning on or after 1 January 2019).

The application of these standards, amendments and interpretations has no significant impact on the financial statements of the Central Bank in the current period.

2. BASIS OF PREPARATION (CONTINUED)

2.5. Standards and Interpretations in issue not yet adopted

As at the date of authorization of these financial statements the following standards, revisions and interpretations have been published by the IASB, but are not yet effective and have not been adopted early by the Central Bank:

- Amendments to references to the Conceptual framework in IFRS standards (effective for annual periods beginning on or after 1 January 2020),
- Amendments to IFRS 3: "Business combinations – Definition of business" (effective for annual periods beginning on or after 1 January 2020),
- Amendments to IAS 1: "Presentation of financial statements" and IAS 8: "Accounting policies, changes in accounting estimates and errors - definition of material" (effective for annual periods beginning on or after 1 January 2020),
- IFRS 17: "Insurance Contracts" (effective for annual periods beginning on or after 1 January 2021),
- Amendments to IFRS 9: "Financial instruments" and IFRS 7: „Disclosures – Interest rate benchmark reform" (effective for annual periods beginning on or after 1 January 2022),
- Amendments to IAS 1: "Presentation of financial statements – Classification of liabilities as current or non-current" (effective for annual periods beginning on or after 1 January 2022).

The Central Bank has elected not to adopt these standards, revisions and interpretations in advance of their effective dates. The Central Bank anticipates that the adoption of these standards, revisions and interpretations will not have a significant impact on the financial statements of the Central Bank.

3. SIGNIFICANT ACCOUNTING POLICIES

Accounting policies set out below have been applied consistently to all periods presented in these financial statements.

3.1. Income and expense recognition

3.1.1. Interest income and expenses

Effective interest rate
Interest income and expenses are recorded in profit or loss using the effective interest rate method. The "effective interest rate" is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to:

- gross carrying amount of the financial assets or
- the amortised cost of the financial liability.

The "amortised cost" of a financial assets or financial liability is the amount at which the financial assets or financial liability is measured on initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount and, for financial assets, adjusted for any expected credit loss allowance.

The gross carrying amount of a financial asset is the amortised cost of a financial asset before adjusted for any expected credit loss allowance.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.1. Income and expense recognition (continued)

3.1.1. Interest income and expenses (continued)

When calculating the effective interest rate for financial instrument, the Central Bank estimates future cash flows considering all contractual terms of the financial instruments, but not expected credit losses. The calculation includes all fees and points paid or received between the Central Bank and other party that are an integral part of the effective interest rate, transaction costs, and all other discounts and premiums.

The effective interest rate method is the method that is used in the calculation of the amortised cost (gross carrying amount) of a financial assets or financial liabilities and allocation and recognition of interest income or expense in profit or loss over the relevant period.

The Central Bank's interest income calculated using the effective interest rate method includes interest income on financial assets at amortised cost and financial assets at fair value through other comprehensive income.

Accrued interest on financial assets with negative interest rate is recognised as an interest expense in profit or loss and arises from deposits with foreign banks and debt instruments at fair value through other comprehensive income.

Accrued interest on financial liabilities with negative interest rate is recognized as an interest income in profit or loss and arises from deposits from domestic commercial banks.

3.1.2. Fee and commission income and expenses

Fee and commission income is earned from the services provided by the Central Bank and is recognized in profit or loss when the service is provided. The Central Bank calculates fee and commission income under determined tariffs for its services.

Fee and commission expense arises from fees spent on foreign payment transactions and is recognized in profit or loss when the service is received.

3.1.3. Foreign currency transactions and exchange differences

On initial recognition, a foreign currency transactions are recorded into the KM, by applying to the foreign currency amount the spot exchange rate between the KM and the foreign currency at the date of the transaction.

Monetary items denominated in foreign currencies are translated to the KM by applying the Central Bank's exchange rate at the reporting date. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated by applying the exchange rate at the date of transaction. Non-monetary items that are measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was measured.

Exchange differences arising on the settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition during the period or in previous reporting date, are recognized in profit or loss when they arise. Due to the currency board rule, there are no exchange differences from monetary items denominated in EUR currency.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.1. Income and expense recognition (continued)

3.1.3. Foreign currency transactions and exchange differences (continued)

Middle exchange rate of most relevant currencies are provided below:

Middle exchange rate:	31 December 2019	31 December 2018
	KM	KM
USD	1.747994	1.707552
SDR	2.417171	2.374847

3.1.4. Dividend income

Dividend income from equity instruments is recognized in profit or loss when the Central Bank's right to receive dividend is established.

3.2. Financial assets and financial liabilities

3.2.1. Recognition and initial measurement of financial assets and financial liabilities

Financial assets and financial liabilities are recognized in the statement of financial position when, and only when, the Central Bank becomes a party to the contractual provisions of the financial asset or liability.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities, except those classified at fair value through profit and loss, are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognized directly in profit or loss.

All financial assets are initially recognised at the settlement date which is the date that an asset is obtained from, or delivered to, the Central Bank.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.2. Financial assets and financial liabilities (continued)

3.2.2. Classification and subsequent measurement

3.2.2.1. Financial assets

The Central Bank can classify its financial assets in the following measurement categories:
- Fair value through other comprehensive income
- Amortised cost and
- Fair value through profit or loss.

As at reporting dates, the Central Bank did not have any financial assets categorised at fair value through profit or loss.

The classification of financial asset is determined by both:
- The Central Bank's business model for managing the financial asset
- The contractual cash flow characteristics of the financial assets.

Business model

The business model reflects how the Central Bank manages the assets in order to generate cash flows. That is, whether the Central Bank's objective is solely to collect the contractual cash flows or to collect both, contractual cash flows and cash flows arising from the sale of assets. If neither of these is applicable, then the financial assets are classified as part of "Other" business model and measured at fair value through profit or loss. As at reporting dates, the Central Bank manages its assets through following business models:
1. "Hold to collect contractual cash flows" model for financial assets that generate contractual cash flows during its lifetime and
2. "Hold to collect contractual cash flows and sell" model for financial assets that generate contractual cash flows during its lifetime and by selling.

Contractual cash flows from debt instruments can be managed by both business models. As at reporting dates, the Central Bank's objective is to collect both contractual cash flows and cash flows arising from the sale for all debt foreign government instruments.

For financial assets that are managed through these models, the Central Bank assesses whether the contractual cash flows associated with the financial asset are solely payments of principal and interest on the principal amount outstanding. The assessment is made at a portfolio level because this best reflects the way the business is managed. For the purpose of assessment, "principal" is defined as fair value of the financial asset on initial recognition. "Interest" is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time, and for other basic lending risks and costs related to the holding the financial asset.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.2. Financial assets and financial liabilities (continued)

3.2.2. Classification and subsequent measurement (continued)

3.2.2.1. Financial assets (continued)

In assessing whether the contractual cash flows are "solely payment of principal and interest", the Central Bank considers the contractual cash flows of the instrument. Only financial assets that satisfies "solely payment of principal and interest" requirement can be classified into category of financial assets measured at amortised cost or financial assets measured at fair value through other comprehensive income.

The Central Bank's financial assets are recognised at: amortised cost or at fair value through other comprehensive income based on assessments of the Central Bank's business model. Financial assets meet the "solely payment of principal and interest" requirement as at reporting dates.

Financial assets at amortised cost

Financial assets are measured at amortised cost if the assets meet the following conditions:

- they are held within the business model whose objective is to hold the financial assets and collect its contractual cash flows and
- the contractual terms of the financial assets give rise on specified dates to cash flows that are solely payments of principal and interest of the principal amount outstanding.

After initial recognition, financial assets are measured at amortised cost using the effective interest rate method on the gross carrying amount of the asset. Effects of subsequent measurement of financial assets at amortised cost are recognised in profit or loss as interest income or interest expense in the period they occurred.

As at reporting dates, the Central Bank's giro accounts, foreign currency in cash, deposits with foreign banks, special drawing rights with the IMF and other financial assets fall into this category of financial instruments.

Financial assets at fair value through other comprehensive income

Financial assets are measured at fair value through other comprehensive income if the assets meet the following conditions:

- they are held within the business model whose objective is achieved by both collecting contractual cash flows and selling financial asset and
- the contractual terms of the financial assets give rise on specified dates to cash flows that are solely payments of principal and interest of the principal amount outstanding.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.2. Financial assets and financial liabilities (continued)

3.2.2. Classification and subsequent measurement (continued)

3.2.2.1. Financial assets (continued)

Debt instruments

After initial recognition, debt instruments are measured at fair value through other comprehensive income using the effective interest rate method on the gross carrying amount of the asset and are adjusted to the fair value of the instrument at each reporting date. For the period of holding, effects of subsequent measurement of debt instruments at fair value through other comprehensive income are recognised as follows:

- Interest income or interest expense is recognised in profit or loss in the period they occurred
- Fair value adjustments are recognised in other comprehensive income in the period they occurred.

When debt instruments at fair value through other comprehensive income are derecognised, the cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to profit or loss, including previously recognised impairment gains or losses.

As at reporting dates, the Central Bank's debt instruments fall into this category of financial instruments.

Equity instruments

The Central Bank has made an irrevocable election to present in other comprehensive income subsequent changes in the fair value of equity instruments that are not held for trading due to their specific characteristics and absence of non-active market for trading. Equity instruments are initially measured at cost which is considered to be their fair value.

As at reporting dates, the Central Bank's all equity instruments at fair value through other comprehensive income are composed of Bank for International Settlement (BIS) and SWIFT shares.

3.2.2.2. Financial liabilities

The Central Bank classifies all its financial liabilities as measured at amortised cost using the effective interest rate method. Interest income or interest expense from financial liabilities measured at amortised cost are recognised in profit or loss.

Financial liabilities measured at amortised cost include currency in circulation, deposits from domestic commercial banks, deposits from the Government and other public depositors and other financial liabilities.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.2. Financial assets and financial liabilities (continued)

3.2.3. Impairment of financial assets

Impairment requirements of financial assets use more forward-looking information to recognise expected credit losses. Instruments within the scope of these requirements include financial assets measured at amortised cost i.e. deposits with foreign banks, special drawing rights with the IMF and debt instruments measured at fair value through other comprehensive income. The Central Bank uses a simplified approach in calculation of expected credit losses for other receivables. Equity instruments measured at fair value through other comprehensive income are not subject of impairment.

The Central Bank recognises a loss allowance for these losses at each reporting date. The measurement of expected credit losses reflects:
- An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes,
- The time value of money and
- Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

Note 29.1. provides more information about how the expected credit loss allowance is measured.

Loss allowances for expected credit losses are calculated and presented in the statement of financial position as follows:
- Financial assets measured at amortised cost: Expected credit losses are calculated on the gross carrying amount of the assets and recorded as a deduction from the gross carrying amount of the assets and
- Debt instruments at fair value through other comprehensive income: Expected credit losses are calculated on the gross carrying amount of the assets, but loss allowance is recognised in other comprehensive income and does not reduce the carrying amount of the financial assets in the statement of financial position.

Impairment gains and losses are recorded in profit or loss regardless of classification of financial assets at each reporting date.

3.2.4. Derecognition of financial assets and financial liabilities

The Central Bank derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire; or it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity.

A financial liability is derecognised when it is extinguished, discharged or expires.

3.3. Monetary gold

Monetary gold is part of foreign currency reserves of the Central Bank and it is classified as a financial asset. Monetary gold is initially recognized at fair value, including transaction cost directly attributable to the acquisition of the monetary gold.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.3. Monetary gold (continued)

After initial recognition, monetary gold is re-measured at fair value. Unrealized gains and losses arising from changes in fair value, referring to the price changes of monetary gold, are recognized in the fair value reserve account within other comprehensive income. In the event that unrealized losses exceed the balance in the fair reserve for monetary gold at the end of the financial year, the Central Bank shall charge the excess against the period's profit.

On the sale of monetary gold, the Central Bank shall recycle existing unrealized gains and losses through profit and loss.

The fair value of monetary gold is expressed in EUR, converted at the fixed rate of KM at the reporting date and is measured at the last quoted bid price for one ounce of gold (Oz).

3.4. Offsetting

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position on a net basis, only where there is a legally enforceable right to offset the recognized amounts and when there is an intention to present or settle the transactions on the net basis.

Income and expenses are presented on a net basis only when permitted under IFRSs, or for gains and losses arising from a group of similar transactions.

3.5. Cash and cash equivalents

For the purpose of reporting cash flows, cash and cash equivalents comprise the following categories: giro accounts, foreign currency in cash, foreign currency demand deposits, foreign currency deposits with maturity up to three months or less from the date of acquisition and special drawing rights with the IMF.

3.6. Property, equipment and intangible assets

Property, equipment and intangible assets consist of assets obtained from the Central Bank's own funds and cash and non-cash grants.

Property, equipment and intangible assets are stated at cost, less accumulated amortization and any recognized accumulated impairment losses. Cost includes the purchase price and all costs directly related to bringing the asset into operating condition for its intended use. Maintenance and repairs, replacements and improvements of minor importance are expensed as incurred. Significant improvements and replacement of assets are capitalized.

Assets under construction are reported at their cost of construction including costs charged by third parties. Upon completion, all accumulated costs of the asset are transferred to the relevant property, equipment and intangible assets category and subsequently subject to the applicable depreciation rates.

Depreciation and amortization of property, equipment and intangible assets is provided on all assets, except land and assets in the course of construction, on a straight-line basis at prescribed rate designed to write off the cost of the assets over their estimated useful lives. The estimated depreciation and amortization rates during 2018 and 2019 were as follows:

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.6. Property, equipment and intangible assets (continued)

Software	20.0%
Other intangible assets	20.0%
Buildings	1.3% to 4.0%
Equipment	11.0% to 20.0%
Furniture	10.0% to 12.5%
Vehicles	15.5%

Gains and losses on disposal of property and equipment and intangible assets are recognized in profit or loss.

The useful life of the property, equipment and intangible assets is reviewed and adjusted on an annual basis at minimum, if necessary, and it is applied prospectively.

3.7. Impairment of non-financial assets

The carrying amounts of the Central Bank's non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. An impairment loss is recognized whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognized in profit or loss.

The recoverable amount of other assets is the greater of their value in use and fair value less cost to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of amortisation, as if no impairment loss had been recognized.

3.8. Provisions for liabilities and charges

Provisions are recognized when the Central Bank has a present legal or constructive obligation as a result of past events for which it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the amount of the obligation can be made. Provisions are determined by discounting the expected future cash flows at a rate that reflects current market assessments of the time value of money and the risks specific to the liability.

Provisions for liabilities and charges are maintained at the level that the Central Bank's management considers sufficient for absorption of incurred losses. The Management determines the sufficiency of provisions on the basis of insight into specific items, current economic circumstances, risk characteristics of certain transaction categories, as well as other relevant factors.

Provisions are released only for such expenditure in respect of which provisions are recognized at inception. If the outflow of economic benefits to settle the obligations is no longer probable, the provision is reversed.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.9. Grants

Grants related to assets, including non-cash grants, are initially recognized as deferred income at fair value and are then recognized as income from grants on a systematic basis over the useful life of the assets. Grants that compensate the Central Bank for expenses incurred are recognized in profit or loss as income from grants on a systematic basis in the same periods in which the expenses are recognized.

3.10. Taxes

The Central Bank is obliged to pay Value Added Tax for all goods and services purchased. These payables are part of the Central Bank's administrative and other operating expenses. According to the laws on corporate income tax (both Federation of Bosnia and Herzegovina and Republic of Srpska), the Central Bank is excluded from income tax payables.

3.11. Currency in circulation

The Central Bank administers the issue and withdrawal of domestic banknotes and coins. The corresponding liability from the issued currency in circulation is recorded in the statement of financial position.

When currency is withdrawn from circulation, it is recognized as a liability as part of currency in circulation, until the formal date of withdrawal. Any outstanding amount not withdrawn, after the formal due date, is recognized as income.

Costs related to the production and design of banknotes and coins are initially recognized as deferred costs which are subsequently amortised through other operating expenses over the period of five years.

3.12. Domestic deposits

Domestic deposits include deposits from banks and deposits from the Government and other public depositors. These deposits are the Central Bank's financial liabilities that are initially recognised at fair value and subsequently measured at amortised cost. Domestic deposits include domestic commercial banks' deposits arising from required reserve policy of the Central Bank, other bank deposits, deposits from BH institutions and deposits from other public institutions in BH. The Central Bank's role as a depository and as well as the banker, adviser and fiscal agent are prescribed under the Law on the Central Bank.

3.13. Managed funds for and on behalf of third parties

The Central Bank also maintains certain accounts in foreign currencies related to agreements concluded between the governments in BH and its constituent entities and foreign governments and financial organisations, as well as foreign currency accounts of state institutions and agencies, and of commercial banks, for which the Central Bank acts as an agent.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.14. Employee benefits

Short-term employee benefits

In accordance with local regulations, on behalf of its employees, the Central Bank pays personal income tax and contributions for pension, disability, health and unemployment insurance, on and from salaries, which are calculated as per the set legal rates during the course of the year on the gross salary. The Central Bank pays those tax and contributions in the favour of the institutions of the Federation of Bosnia and Herzegovina (on federal and cantonal levels), Republic of Srpska and Brčko District.

In addition, meal allowances, transport allowances and vacation bonuses are paid in accordance with the domestic legislation requirements. These expenses are recognized in profit or loss in the period in which the expense is incurred.

Long-term employee benefits

According to local legal requirements, employees of the Central Bank are entitled to receive a one-time benefit on retirement, provided legal conditions are met, such as the age or years of service, which in accordance with the Central Bank's internal Acts is based on six regular monthly salaries paid to the respective employee in the last six months.

Such payments are treated as long-term employee benefits which are calculated annually by independent actuaries using the projected unit credit method. The discount rate used in the calculation of the liability is based on interest rates of domestic corporate bonds and government bonds which exist on the market.

3.15. Financial arrangements of Bosnia and Herzegovina with the International Monetary Fund

According to the financial arrangements made at the end of 2002 between BH and the International Monetary Fund ("IMF"), the statement of financial position of the Central Bank includes the following items related to BH's membership of the IMF: holdings of special drawing rights, accrued interest on such holdings and the IMF No. 1 account and IMF No. 2 account.

Other assets and liabilities related to the IMF, belonging to or being the responsibility of BH, are recorded in a special Trust Fund within off-balance-sheet records (see also Note 31).

3.16. Assumptions and estimation uncertainties

The preparation of financial statements in conformity with IFRSs requires the Management to make judgements, estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure contingent assets and liabilities at the date of the financial statements and their reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Changes in accounting estimates are recognized in the period in which the estimate is changed if the change affects only that period or in the period of change and future periods if the change affects both current and future periods.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.16. Assumptions and estimation uncertainties (continued)

Key assumptions and estimates relating to material statement of financial position items are presented below:

Business model

Note 3.2.2.1.: Determination of the business model within which the assets are held and assessment of contractual terms of financial assets regarding the "Solely payment of principal and interest" requirement. These assessments determine the classification of financial assets.

Impairment of financial assets

The Central Bank calculates the expected credit losses for certain classes of financial assets measured at amortised cost and debt instruments measured at fair value through other comprehensive income. Note 29.1 describes assumptions made in the determination of the inputs into the expected credit loss measurement model, including the forward-looking view information that were used in the reporting periods.

Fair value of assets and liabilities

The Central Bank's policy is to disclose fair value information on those financial assets and financial liabilities for which public market information is readily available or such value may be calculated by applying some alternative valuation techniques, and whose fair value is materially different from their recorded amounts. According to the Central Bank's management, amounts presented in the financial statements reflect the most reliable and useful estimate of fair value for financial reporting purposes, in accordance with IFRS. For more information about fair value measurement of financial assets and financial liabilities see Note 30.

Depreciation and amortisation charge and rates applied

The calculation of depreciation and amortisation, as well as depreciation and amortisation rates are based on the assessed economic useful life of property, equipment and intangible assets. Once a year, the Central Bank assesses economic useful life based on current assumptions.

4. NET INTEREST INCOME

In thousands of KM

	For the year ended 31 December	
Interest income arising from:	2019	2018
Debt instruments (Note 14)	40,042	42,334
Effects of negative deposit interest rates on deposits from domestic commercial banks	11,093	5,784
Deposits with foreign banks	29	37
Other financial assets at amortised cost	14	31
Total	**51,178**	**48,186**
Interest expense arising from:		
Effects of negative interest rates from debt instruments (Note 14)	(13,553)	(13,613)
Effects of negative interest rates from deposits with foreign banks	(12,805)	(10,780)
Total	**(26,358)**	**(24,393)**
Net interest income	**24,820**	**23,793**

The base for calculation of interest on deposits from domestic commercial banks includes the total deposits of commercial banks on reserve accounts during the ten day settlement period, which consists of required reserve amounts and excess above the required reserves.

The base for the required reserve calculation for domestic commercial banks consists of deposits and borrowings regardless of fund currency expressed. Also, the unique required reserve ratio of 10% is established to be applied by the Central Bank on the required reserve base.

The Central Bank does not calculate fee on the required reserve amount while the calculation of fee on the amount exceeding the required reserve is linked to the European Central Bank deposit facility rate. Up to 1 May 2019, the fee on the amount exceeding required reserves was calculated by the rate equal to 50% of the European Central Bank deposit facility rate. Starting from 1 May 2019, the fee on the amount exceeding required reserves is calculated by deposit facility rate of European Central Bank.

Effects of negative interest rates on deposits from local commercial banks are result of the negative interest rate for domestic commercial banks on the amount exceeding the required reserve. During the reporting periods the fees on the amount exceeding the required reserve were as follows:

Period	Interest rate	European Central Bank deposit facility rate
2019		
from 1 January to 30 April	(0.20)%	(0.40)%
from 1 May to 11 September	(0.40)%	(0.40)%
from 12 September to 31 December	(0.50)%	(0.50)%
2018		
from 1 January to 31 December	(0.20)%	(0.40)%

4. NET INTEREST INCOME (CONTINUED)

Effects of negative interest rates from deposits with foreign banks include the amount of KM 10,018 thousand on term deposits and the amount of KM 2,787 thousand on demand deposits (2018: included the amount of KM 8,507 thousand on term deposits and the amount of KM 2,273 thousand on demand deposits).

Effects of negative interest rates from interest-bearing financial assets are result of the negative interest rates calculated on deposits with foreign banks and debt instruments that could not be avoided according to current market circumstances.

5. NET FEE AND COMMISSION INCOME

	For the year ended 31 December	
In thousands of KM	2019	2018
Fee and commission income arising from:		
services for local commercial banks	16,089	16,047
services for the Government and other non-banking clients	1,576	1,162
Total	**17,665**	**17,209**
Fee and commission expenses arising from:		
transactions with foreign banks	(653)	(636)
Total	**(653)**	**(636)**
Net fee and commission income	**17,012**	**16,573**

6. NET REALISED GAINS FROM SALE OF DEBT INSTRUMENTS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

	For the year ended 31 December	
In thousands of KM	2019	2018
Realised gains	238	4,277
Realised losses	-	-
Net realised gains from sale of debt instruments at fair value through other comprehensive income	**238**	**4,277**

Net realised gains from sale of debt instruments at fair value through other comprehensive income include net amount comprised of closing balance in fair value reserves in the amount of KM 186 thousand and provisions for expected credit losses in the amount of KM 52 thousand for the year ended 31 December 2019 (For the year ended 31 December 2018: net realised gains from sale of debt instruments at fair value through other comprehensive income included net amount comprising from closing balance in fair value reserves in the amount of KM 1,679 thousand and in provisions for expected credit losses in the amount of KM 2,598 thousand). For more information see Note 29.1.1.

7. NET FOREIGN EXCHANGE GAINS

In thousands of KM	For the year ended 31 December 2019	2018
Gains from foreign exchange differences	722	727
Losses from foreign exchange differences	(455)	(576)
Net foreign exchange gains	**267**	**151**

8. OTHER INCOME

In thousands of KM	For the year ended 31 December 2019	2018
Dividend income (Note 18)	623	589
Income from grants	98	144
Other income	174	789
TOTAL	895	1,522

9. PERSONNEL EXPENSES

In thousands of KM	For the year ended 31 December 2019	2018
Salaries	10,645	10,515
Contributions and other fees on salaries	6,064	5,977
Other employee benefits	2,019	2,024
Contributions and other fees on other employee benefits	665	670
Net provisions for severance payments, net increase / (decrease) (Note 22)	277	(152)
TOTAL	19,670	19,034

Personnel expenses include KM 3,749 thousand (2018: KM 3,702 thousand) of defined pension contributions paid into the public pension funds in BH. Contributions are calculated as percentage of the gross salary. As at 31 December 2019 the Bank had 370 employees (2018: 368 employees).
Other employee benefits are mainly comprised of expenses arising from meal allowances, transport services and vacation bonuses.

10. ADMINISTRATIVE AND OTHER OPERATING EXPENSES

In thousands of KM	For the year ended 31 December 2019	2018
Maintenance costs	2,134	2,695
Expenses for production and design of banknotes and coins	1,959	1,751
Other administrative and operating expenses	3,857	3,804
TOTAL	7,950	8,250

11. PROVISIONS FOR EXPECTED CREDIT LOSSES, NET DECREASE / (INCREASE)

In thousands of KM	For the year ended 31 December 2019	2018
Gains from expected credit losses arising from:		
Debt instruments:	8,022	15,122
Change in PD calculation (Notes 29.1. and 29.1.1)	*7,704*	-
Change in credit risk	*318*	*15,122*
Deposits with foreign banks	4,940	9,266
Change in PD calculation (Notes 29.1. and 29.1.1)	*2,117*	-
Change in credit risk	*2,823*	*9,266*
Other financial assets	7	64
Change in credit risk	7	64
Special drawing rights with the IMF	-	3
Change in credit risk	-	*3*
	12,969	24,455
Allowance for expected credit losses arising from:		
Debt instruments	(424)	(22,423)
Deposits with foreign banks	(3,129)	(10,165)
Other financial assets	(7)	(39)
Special drawing rights with the IMF	-	(3)
	(3,560)	(32,630)
Provisions for expected credit losses, net decrease / (increase)	9,409	(8,175)

12. FOREIGN CURRENCY IN CASH

Foreign currency in cash relates to:

In thousands of KM	31 December 2019	31 December 2018
Cash in vaults per currency:		
- EUR	322,523	274,025
- CHF	39	38
- USD	20	20
- GBP	17	16
TOTAL	322,599	274,099

13. DEPOSITS WITH FOREIGN BANKS

Term and demand deposits with foreign banks, analysed by type of currency, are as follows:

In thousands of KM	31 December 2019	31 December 2018
Term deposits:		
- EUR	2,308,476	2,118,444
Less impairment for expected credit losses	(495)	(2,064)
	2,307,981	2,116,380
Demand deposits:		
- EUR	784,914	788,997
- CHF	5,999	3,741
- GBP	2,220	36
- USD	1,880	2,765
Less impairment for expected credit losses	(229)	(471)
	794,784	795,068
TOTAL	3,102,765	2,911,448

Term deposits with foreign banks, analysed by remaining contractual maturity, are as follows:

In thousands of KM	31 December 2019	31 December 2018
Up to 1 month	1,184,603	777,266
From 1 to 2 months	155,675	349,106
From 2 to 3 months	272,789	583,230
From 3 to 4 months	192,865	155,532
From 4 to 12 months	502,544	253,310
Total	2,308,476	2,118,444
Less impairment for expected credit losses	(495)	(2,064)
TOTAL	2,307,981	2,116,380

13. DEPOSITS WITH FOREIGN BANKS (CONTINUED)

During the year 2019 the negative interest rates on demand deposits denominated in EUR ranged from 0.75% p.a. to 0.30% p.a. (2018: negative interest rates from 0.72% p.a. to 0.08% p.a.) and on term deposits negative interest rates ranged from 0.52% p.a. to 0.34% p.a. (2018: from 0.48% p.a. to 0.17% p.a.).

Deposits with foreign banks include negative accrued interest in the amount KM 1,423 thousand as at 31 December 2019 (2018: included negative accrued interest in the amount KM 2,395 thousand).

The average negative effective yield rate on deposits with foreign banks amounted to 0.42% p.a. (2018: average negative effective yield rate 0.42% p.a.).

Deposits with foreign banks analysed by the type of the bank invested in, are as follows:

In thousands of KM	31 December 2019	31 December 2018
Central banks	1,594,746	2,009,539
Commercial banks	1,508,743	904,444
Less impairment for expected credit losses (Note 29.1.1)	(724)	(2,535)
TOTAL	3,102,765	2,911,448

13. DEPOSITS WITH FOREIGN BANKS (CONTINUED)

Deposits with foreign banks can be analysed on a geographical basis as follows:

In thousands of KM	31 December 2019	31 December 2018
Luxembourg		
Term deposits	869,747	1,224,011
Demand deposits	234,598	234,620
	1,104,345	1,458,631
Switzerland		
Term deposits	482,345	484,453
Demand deposits	101	1,000
	482,446	485,453
France		
Term deposits	391,166	-
Demand deposits	78,200	78,206
	469,366	78,206
Germany		
Term deposits	-	-
Demand deposits	421,679	479,941
	421,679	479,941
Great Britain		
Term deposits	408,933	409,980
Demand deposits	-	-
	408,933	409,980
Slovakia		
Term deposits	156,285	-
Demand deposits	-	-
	156,285	-
Netherlands		
Term deposits	-	-
Demand deposits	58,649	-
	58,649	-
USA		
Term deposits	-	-
Demand deposits	1,786	1,772
	1,786	1,772
Total term deposits	2,308,476	2,118,444
Total demand deposits	795,013	795,539
Less impairment for expected credit losses	(724)	(2,535)
TOTAL	3,102,765	2,911,448

14. DEBT INSTRUMENTS

Debt instruments are classified at fair value through other comprehensive income, composed of sovereign government bonds with a high degree of marketability and liquidity, with a credit rating from AAA to BBB (See Note 29.1.). The portfolio includes short-term and long-term government bonds with a fixed interest rate. Debt instruments at fair value through other comprehensive income are denominated in EUR.

The structure of debt instruments at fair value through other comprehensive income is as follows:

In thousands of KM	31 December 2019	31 December 2018
Sovereign government bonds	8,848,981	8,153,320
Accrued interest	68,432	72,119
TOTAL	8,917,413	8,225,439

The average effective yield rate on debt instruments at fair value through other comprehensive income amounted to 0.31% p.a. (2018: the average effective yield rate amounted to 0.41% p.a.)

Debt instruments at fair value through other comprehensive income can be analysed on a geographical basis as follows:

	31 December 2019		31 December 2018	
	In thousands of KM	%	In thousands of KM	%
France	2,977,360	33.39	2,211,257	26.87
Germany	1,448,191	16.24	1,504,585	18.29
Belgium	1,010,563	11.33	1,083,041	13.17
Spain	840,620	9.43	844,614	10.27
Netherlands	742,561	8.33	568,172	6.91
Austria	689,066	7.73	950,959	11.56
Italy	624,905	7.01	549,084	6.68
Finland	584,147	6.54	513,727	6.25
TOTAL	8,917,413	100.00	8,225,439	100.00

Movements in fair value of debt instruments at fair value through other comprehensive income can be analysed as follows:

In thousands of KM	2019	2018
As at 1 January	8,225,439	7,473,857
Purchases during the year	3,156,187	3,766,969
Sales during the year	(258,849)	(653,879)
Interest income recognized during the year (Note 4)	40,042	42,334
Effects of negative interest rates recognized during the year (Note 4)	(13,553)	(13,613)
Maturities of debt instruments	(2,198,367)	(2,265,677)
Maturities of coupon	(111,349)	(118,162)
Net change in fair value during the year	77,863	(6,390)
As at 31 December	8,917,413	8,225,439

14. DEBT INSTRUMENTS (CONTINUED)

No expected credit loss allowance is recognised in the statement of financial position for debt instruments measured at fair value through other comprehensive income. Provisions for expected credit losses for debt instruments measured at fair value through other comprehensive income are part of the Central Bank's equity. Movements in provisions for expected credit losses for debt instruments measured at fair value through other comprehensive income during the year are provided in Note 29.1.1.

15. MONETARY GOLD

Fair value of the monetary gold as at 31 December 2019 amounts to KM 254,088 thousand, representing 96,000 ounces of gold at KM 2,647 per ounce (2018: KM 209,996 thousand representing 96,000 ounces of gold at KM 2,187 per ounce).

Movements in fair value of monetary gold can be analysed as follows:

In thousands of KM	2019	2018
As at 1 January – as stated	209,996	203,908
Change in accounting policy as at 1 January	-	(50)
As at 1 January - restated	209,996	203,858
Net change in fair value during the year	44,092	6,138
As at 31 December	254,088	209,996

16. OTHER ASSETS

In thousands of KM	31 December 2019	31 December 2018
Prepaid expenses	7,539	6,811
Receivables from domestic banks	1,833	1,735
Numismatic collections	840	741
Other miscellaneous assets	620	597
Giro accounts	575	553
Loans to employees	55	122
Receivables from employee based on domestic currency deficit	600	600
Less impairment of other receivables	(600)	(600)
Less impairment for expected credit losses	(5)	(5)
TOTAL	11,457	10,554

As at 31 December 2019, prepaid expenses include expenditure of KM 6,973 thousand incurred on the production of banknotes and coins (31 December 2018: KM 5,816 thousand incurred on the production of banknotes and coins). As explained in Note 3.11, such costs are initially deferred and subsequently amortized over a period of five years.

17. PROPERTY, EQUIPMENT AND INTANGIBLE ASSETS

In thousands of KM	Land and buildings	Equipment and furniture	Vehicles	Other	Assets under construction	Property and equipment total	Software and other intangible assets	Intangible assets under construction	Intangible assets total
Cost									
As at 1 January 2018	44,368	24,026	1,924	1,010	682	72,010	14,500	237	14,737
Additions	-	-	-	-	1,322	1,322	-	588	588
Brought into use	-	1,894	45	36	(1,975)	-	541	(541)	-
Write offs and disposals	-	(333)	(59)	(5)	-	(397)	(24)	-	(24)
As at 31 December 2018	44,368	25,587	1,910	1,041	29	72,935	15,017	284	15,301
Additions	-	-	-	-	5,620	5,620	-	691	691
Brought into use	-	804	-	30	(834)	-	616	(616)	-
Write offs	-	(1,415)	(47)	(2)	-	(1,464)	(172)	-	(172)
As at 31 December 2019	44,368	24,976	1,863	1,069	4,815	77,091	15,461	359	15,820
Accumulated depreciation and amortization									
As at 1 January 2018	4,640	19,685	1,492	728	-	26,545	13,665	-	13,665
Charge for the year	755	1,198	97	58	-	2,108	318	-	318
Write offs and disposals	-	(331)	(59)	(5)	-	(395)	(24)	-	(24)
As at 31 December 2018	5,395	20,552	1,530	781	-	28,258	13,959	-	13,959
Charge for the year	579	1,255	93	49	-	1,976	470	-	470
Write offs and disposals	-	(1,408)	(47)	(2)	-	(1,457)	(172)	-	(172)
As at 31 December 2019	5,974	20,399	1,576	828	-	28,777	14,257	-	14,257
Net book value									
As at 1 January 2019	38,973	5,035	380	260	29	44,677	1,058	284	1,342
As at 31 December 2019	38,394	4,577	287	241	4,815	48,314	1,204	359	1,563

Assets under construction relate mainly to acquisition of the land for new business premises for Main Unit of Sarajevo of the Central Bank in the amount of KM 4,767 thousand as at 31 December 2019.

As at 31 December 2019 and 2018, the Central Bank has no encumbrances over its property, equipment and intangible assets.

18. OTHER INVESTMENTS

The structure of other investments is as follows:

In thousands of KM	31 December 2019	31 December 2018
Equity instruments:		
Shares in BIS (Note 24)	27,803	27,803
Shares in SWIFT	10	10
TOTAL	27,813	27,813

Equity instruments are composed of ordinary BIS shares with a nominal value of SDR 5,000 per share (paid up at 25% of their nominal value by former Yugoslavia). In accordance with the Statue of BIS, remaining 75% of the share's nominal value is payable upon call for payment from BIS by the Central Bank.

SWIFT shares are composed of two ordinary shares and their total value is KM 10 thousand.

BIS and SWIFT shares represent unquoted equity instruments whose fair value cannot be reliably determined.

During the year the Central Bank received dividend income from BIS in the amount of KM 623 thousand (2018: KM 589 thousand) (Note 8).

19. CURRENCY IN CIRCULATION

Currency in circulation can be analysed as follows:

In thousands of KM	2019	2018
Currency placed into circulation - as at 1 January	4,750,614	4,319,360
Increase in currency in circulation during the year	449,302	431,254
Currency placed into circulation - as at 31 December	5,199,916	4,750,614

19. CURRENCY IN CIRCULATION (CONTINUED)

		31 December 2019		31 December 2018	
	Nominal value	Pieces	Value in thousands of KM	Pieces	Value in thousands of KM
Coins	0.05	77,246,288	3,862	70,591,960	3,529
Coins	0.10	112,021,868	11,202	103,899,364	10,390
Coins	0.20	81,275,215	16,255	75,154,592	15,031
Coins	0.50	38,932,789	19,466	36,191,317	18,096
Coins	1	57,804,822	57,805	52,287,706	52,288
Coins	2	14,951,396	29,903	14,653,353	29,307
Coins	5	11,945,662	59,728	10,871,548	54,358
Banknotes	10	13,746,862	137,469	12,889,248	128,891
Banknotes	20	8,762,192	175,244	8,354,535	167,091
Banknotes	50	20,561,074	1,028,054	19,623,638	981,182
Banknotes	100	27,672,872	2,767,287	24,249,404	2,424,940
Banknotes	200	4,468,203	893,641	4,327,553	865,511
TOTAL		469,389,243	5,199,916	433,094,218	4,750,614

20. DEPOSITS FROM BANKS

The structure of deposits from banks is provided in the following table:

In thousands of KM	31 December 2019	31 December 2018
Deposits of domestic commercial banks	5,743,011	5,522,701
Reserve accounts of organizational units of the Central Bank	575	553
Special deposit of domestic commercial banks – blocked funds	33	36
TOTAL	5,743,619	5,523,290

Deposits of domestic commercial banks are placed in accordance with required reserve requirements for those banks to meet obligations for settling debts and for the transactions between commercial banks and the Central Bank. As at 31 December 2019 the total amount of KM 5,743,011 thousand represents deposits of 24 banks (2018: KM 5,522,701 thousand represented deposits of 24 banks).

Interest on deposits from domestic commercial banks is calculated according to the Law on the Central Bank on the amount exceeding the required reserve. Calculation policy for interest rate on deposits placed by domestic commercial banks during the reporting periods is provided in Note 4.

Deposits from banks include negative accrued interest in the amount KM 1,304 thousand as at 31 December 2019 (31 December 2018: included negative accrued interest in the amount KM 513 thousand).

21. DEPOSITS FROM THE GOVERNMENT AND OTHER PUBLIC DEPOSITORS

The structure of deposits from the Government and other public depositors is provided in the following table:

In thousands of KM	31 December 2019	31 December 2018
Deposits for the budget of BH Institutions	553,745	494,575
Deposits of other public institutions	176,640	125,501
Deposits of other governments and government institutions	150,285	89,286
Deposit account under the IMF transactions	5	5
TOTAL	880,675	709,367

22. PROVISIONS FOR LIABILITIES AND CHARGES

Provisions for liabilities and charges relate to provisions for employees' severance payments and provisions for potential liabilities on litigations.

Litigations
The Central Bank is a defendant in few legal proceedings arising from its operations. The Central Bank contests this claims and based on legal advice considers that no material liabilities will be incurred.

Movement in provisions for liabilities and charges is presented below:

In thousands of KM

	Litigations	Severance payments	2019 Total
As at 1 January	-	1,259	1,259
Released provisions	-	(7)	(7)
Increase in provisions	-	284	284
Total recognized in profit or loss	-	277	277
Amounts paid	-	(142)	(142)
As at 31 December	-	1,394	1,394

In thousands of KM

	Litigations	Severance payments	2018 Total
As at 1 January	150	1,500	1,650
Released provisions	(70)	(152)	(222)
Increase in provisions	-	-	-
Total recognized in profit or loss	(70)	(152)	(222)
Amounts paid	(80)	(89)	(169)
As at 31 December	-	1,259	1,259

23. OTHER LIABILITIES

The structure of other liabilities is presented in the following table:

In thousands of KM	31 December 2019	31 December 2018
Suppliers	2,095	1,036
IMF Accounts No. 1 and 2 (Note 31)	1,657	1,628
Accrued expenses and other liabilities	224	177
Deferred income	69	167
World bank deposits	52	184
Liabilities to employees	-	35
TOTAL	4,097	3,227

24. EQUITY

The structure of equity is presented in the following table:

In thousands of KM	31 December 2019	31 December 2018
Initial capital	25,000	25,000
General reserves (Retained earnings)	537,295	514,720
Other reserves	31,300	31,300
Fair value reserves for debt and equity instruments at fair value through other comprehensive income	211,373	133,696
Provisions for expected credit losses	1,343	8,993
Fair value reserves for monetary gold	50,230	6,138
TOTAL	856,541	719,847

Initial capital

Initial capital represents nominal capital paid in on 12 June 1998 in accordance with the Law on Central Bank.

General reserves (Retained earnings)

General reserves (Retained earnings) comprise accumulated undistributed profits of the Central Bank since the beginning of its operations on 11 August 1997. Status of General reserves (Retained earnings) is in jurisdiction of the Central Bank's Governing Board. General reserves (Retained earnings) are primary used for the Central Bank's net loss allocation, as prescribed under the Article 28 of the Law on the Central Bank.

24. EQUITY (CONTINUED)

Other reserves

Other reserves relate to following:

- Special reserves from grants in the amount of KM 3,497 thousand, which relate to grants received in cash from the Council of Ministers of Bosnia and Herzegovina on 12 June 1998. The status of these reserves is regulated by the Decision of the Governing Board of the Central Bank with the approval of the Presidency of Bosnia and Herzegovina. The right to utilise the reserves from grants fall within the competence of the Governing Board of the Central Bank.
- Amounts received in accordance with the Succession Agreement of the former Yugoslavia in the amount of KM 27,803 thousand and relates to shares in BIS (see Note 18).

25. PROFIT ALLOCATION

The allocation of the net profit is carried out in accordance with the Law on the Central Bank.

The provisions of the Law on the Central Bank define the criteria of the net profit allocation, according to which the Central Bank allocates 60% of the current profit to the account of the institution responsible for the Budget of BH, provided that the amount of the initial capital and general reserves (retained earnings) is equal to 5.00% of the total monetary liabilities.

This ratio, before the profit allocation in 2019 amounted to 4.56% (2018: 4.84%). According to the Decision of the Governing Board, total amount of net profit for the 2019 financial year in the amount of KM 22,575 thousand is allocated to the general reserves (retained earnings) of the Central Bank (2018: total of the net profit for the 2018 financial year in the amount of KM 8,431 thousand was allocated to the general reserves (retained earnings) of the Central Bank).

2019

Before profit allocation

	(In thousands of KM)
Monetary liabilities	**11,824,210**
Initial capital and general reserves (retained earnings)	539,720
Ratio - initial capital and general reserves (retained earnings) / monetary liabilities	**4.56%**

Profit allocation

	(In thousands of KM)
Net profit before allocation	**22,575**
Allocation of profit to general reserves (retained earnings)	22,575

After profit allocation

	(In thousands of KM)
Monetary liabilities	**11.824.210**
Initial capital and general reserves (retained earnings)	562.295
Ratio - Initial capital and general reserves (retained earnings) / monetary liabilities	**4.76%**

25. PROFIT ALLOCATION (CONTINUED)

2018

Before profit allocation

	(In thousands of KM)
Monetary liabilities	**10,983,271**
Initial capital and general reserves (retained earnings)	531,289
Ratio - initial capital and general reserves (retained earnings) / monetary liabilities	**4.84%**

Profit allocation

	(In thousands of KM)
Net profit before allocation	**8,431**
Allocation of profit to general reserves (retained earnings)	8,431

After profit allocation

	(In thousands of KM)
Monetary liabilities	**10,983,271**
Initial capital and general reserves (retained earnings)	539,720
Ratio - Initial capital and general reserves (retained earnings) / monetary liabilities	**4.91%**

26. CASH AND CASH EQUIVALENTS

For the purposes of the cash flow statement, cash and cash equivalents comprise of:

In thousands of KM	31 December 2019	31 December 2018
Foreign currency deposits with maturity up to three months or less from the date of acquisition	1,381,184	605,552
Foreign currency demand deposits	795,013	795,539
Foreign currency in cash	322,599	274,099
Giro accounts	575	553
Special Drawing Rights with the IMF	230	2,236
Total	**2,499,601**	**1,677,979**
Less impairment for expected credit losses	(629)	(1,619)
TOTAL	2,498,972	1,676,360

26. CASH AND CASH EQUIVALENTS (CONTINUED)

Movements in expected credit losses on cash and cash equivalents in the reporting periods are provided below:

In thousands of KM	2019	2018
As at 1 January - stated	**1,619**	-
Effects from expected credit losses on cash and cash equivalents under IFRS 9	-	1,283
As at 1 January - restated	**1,619**	**1,283**
Foreign currency demand deposits	(242)	(92)
Foreign currency deposits with maturity up to three months or less from the date of acquisition	(748)	428
Foreign currency in cash	-	-
Special Drawing Rights with the IMF	-	-
Giro accounts	-	-
As at 31 December	**629**	**1,619**

27. CURRENCY BOARD ARRANGEMENT

The Law on the Central Bank defines the operational rules for a "Currency Board" to be used for issuing KM, according to which KM is issued only full coverage in net foreign currency reserves.

Article 31 of the Law on the Central Bank requires that the aggregate amount of its monetary liabilities shall at no time exceed its net foreign currency reserves.

Details of compliance with the rule are as follows:

In thousands of KM	31 December 2019	31 December 2018
Gross foreign currency reserves	**12,597,095**	**11,623,218**
Foreign currency in cash	322,599	274,099
Deposits with foreign banks	3,102,765	2,911,448
Debt instruments	8,917,413	8,225,439
Monetary gold	254,088	209,996
Special drawing rights with the IMF	230	2,236
Liabilities to non-residents	1,709	1,812
Net foreign currency reserves (gross foreign currency reserves less liabilities to non-residents)	**12,595,386**	**11,621,406**
Monetary liabilities	**11,824,210**	**10,983,271**
Currency in circulation	5,199,916	4,750,614
Deposits from banks	5,743,619	5,523,290
Deposits from the Government and other public depositors	880,675	709,367
NET FOREIGN ASSETS (net foreign currency reserves less monetary liabilities)	**771,176**	**638,135**

28. RELATED PARTY TRANSACTIONS

In the normal course of its operations, the Central Bank enters into transactions with related parties. Having in mind that the Central Bank has been established by a Legal Act passed by Parliamentary Assembly of Bosnia and Herzegovina and that the initial capital has been paid up by the Council of Ministers of Bosnia and Herzegovina, transactions performed as part of regular operations of the Central Bank with the state and state institutions represent related party transactions. According to the Law on Central Bank, the Central Bank acts as an agent for the BH state and for the other state institutions. The Central Bank receives deposits from the BH state and other state institutions and acts strictly on depositors behalf.

Transactions with the state and state institutions are disclosed in the following table:

In thousands of KM

2019	Liabilities
State	546,735
State institutions	
BH Indirect taxation authority	85,844
BH Deposit Insurance Agency	165,033
TOTAL	797,612

In thousands of KM

2018	Liabilities
State	505,897
State institutions	
BH Indirect taxation authority	45,635
BH Deposit Insurance Agency	90,975
TOTAL	642,507

The Central Bank considers that it has an immediate related party relationship with its key management personnel, close family members of key management personnel, and entities controlled, jointly controlled or significantly influenced by key management personnel and their close family members.

Remuneration of key management members

The total remuneration of the members of the key personnel (members of Management and Governing Board) in 2019 amounted to KM 932 thousand, out of which KM 579 thousand was related to salaries and other remuneration and KM 353 thousand to taxes and contributions (in 2018 out of total amount of KM 964 thousand the amount of KM 590 thousand was related to salaries and other remuneration and KM 374 thousand was related to taxes and contributions).

29. FINANCIAL RISK MANAGEMENT

Financial assets which represents the Central Bank's exposure to financial risks (credit risk, market risks and liquidity risk) are:

- Foreign currency in cash,
- Deposits with foreign banks (central banks, commercial banks and BIS),
- Debt instruments,
- Monetary gold,
- Special drawing rights with the IMF,
- Other financial assets (domestic banks' receivables, employees' loans and other receivables) and
- Other investments.

29.1. Credit risk

Credit risk represents the risk of default on the contractual obligations of other counterparty or the issuer of fixed income debt securities, where the counterparty is an entity where, in accordance with the Central Bank's regulations, foreign currency reserves are held or invested. The management of this risk is performed through:

- limiting the scope of financial instruments,
- limiting counterparties and issuers to those with acceptable composite credit rating,
- defining concentration limits for investments with an individual counterparty,
- limiting the maximum amount to be invested into individual types of financial instruments,
- limiting the size of the issue of individual securities and
- limiting maturities.

For the funds recorded in off-balance sheet records, the Central Bank is not exposed to credit risk, as all the risk, which may result from the investments of these funds, is to be borne contractually by the owners of these funds (see also Note 31).

Expected credit loss measurement

Financial assets for which the Central Bank calculates the expected credit losses includes:

- deposits with foreign banks,
- debt instruments,
- Special drawing rights with IMF and
- other financial assets (domestic banks' receivables, employees' loans and other receivables).

The basic criteria for defining the limit of exposure to credit risk is the composite credit rating. Composite credit rating is the average of current ratings assigned to a certain entity by at least two out of three credit rating agencies (Standard and Poor's, Fitch ratings or Moody's).

Financial assets which have the composite credit rating AA minus (AA-) or higher, the Central Bank treats as low credit risk exposure.

Financial assets which have the composite credit rating from BBB minus (BBB-) to A plus (A+), the Central Bank treats as medium credit risk exposure.

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.1. Credit risk (continued)

Financial assets which have the composite credit rating below BBB minus (BBB-), the Central Bank treats as high credit risk exposure.

In the absence of credit rating, the Central Bank estimates the borrower's capacity to properly repay his contractual cash obligations.

Model for impairment of financial assets defines three stages based on the credit risk level at the initial recognition and changes in credit quality after initial recognition as summarized below:

1. Stage 1 of exposure distribution – Financial assets which are treated as the low or medium credit risk exposure are allocated to Stage 1 at initial recognition. In accordance with internal Central Bank's regulations, investments of foreign currency reserves are not allowed to the high credit risk exposure. Each investment of foreign currency reserves at initial recognition is allocated to Stage 1 of exposure distribution.
2. Stage 2 of exposure distribution – If a significant increase in credit risk since initial recognition is identified, financial assets which were allocated to Stage 1 will be transferred to Stage 2.
3. Stage 3 of exposure distribution – The criteria for movement into the Stage 3 is assigning the default status to financial assets.

The calculation of expected credit losses is measured on a 12-month basis or a lifetime basis, depending on financial asset's composite credit rating level, if the significant increase in credit risk has occurred from the moment of financial assets' initial recognition and depending on if the financial asset is credit-impaired.

For financial assets allocated in Stage 1, the expected credit losses are measured on a 12-month basis, while for financial assets allocated in Stage 2 or Stage 3 the expected credit losses are measured on a lifetime basis.

Significant increase in credit risk

Significant increase in credit risk, as criteria for transfer of exposure into Stage 2, represents:

- decrease in composite credit rating for more than two notches in relation to initial recognition date, excluding the financial assets which even after the decrease in composite credit rating is treated as the low credit risk exposure at reporting date or
- decrease in composite credit rating of financial assets below investment level of composite credit rating, i.e. below the BBB minus (BBB-) rating.

Financial assets cannot be allocated from Stage 1 to Stage 2 if the Central Bank considers that the debtor, which does not have credit rating assigned, has high capacity to settle all matured contractual obligations. Financial assets cannot be allocated to Stage 2 if, even after the decrease in the level of composite credit rating, the financial assets have rating AA minus (AA-) or higher, considering that it is treated as low credit risk exposure.

If financial instrument is consisted of multiple tranches that were initially recognized in different periods, and which in different periods had different composite credit ratings, by using the conservative approach, the Central Bank will take as relevant the calculated increase in credit risk from the highest notch.

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.1. Credit risk (continued)

If the change in credit risk rating occurred due to the change in certain credit rating agency methodology and the significant increase in credit risk did not occur related to initially estimated risks, the exposures will not be classified into the Stage 2.

The Central Bank, based on its analysis, can determine the allocation of every individual financial asset into the Stage 2 or Stage 3. If the causes that led to the transfer of financial asset in Stage 2 have been removed, the exposure can be reverted to Stage 1, but at least 90 days after removal of the cause.

In addition to the criteria mentioned above, stage classification can be performed based on assumption that the significant increase in risk has occurred if the payment is delayed for 30 days or more, where the financial asset will be classified to Stage 2 (underperforming) if the payment is delayed for 30 to 89 days. Financial assets will be classified to the Stage 3 (nonperforming) if payment is delayed for 90 days or more.

Definition of default

Default criteria are objective evidences of impairment and especially:

- Significant financial difficulties of securities' issuers,
- Breach of contractual obligations in terms of delinquency on principal and interest,
- Any restructuring or modification of the existing terms of servicing obligations arising from financial instrument debt for reasons related to financial difficulties of the issuer,
- Probability of bankruptcy and/or liquidation or other form of financial reorganization and/or
- Disappearance of an active trading market.

Expected credit loss calculation

Expected credit losses are calculated as the product of three variables: the Probability of Default (PD), Loss Given Default (LGD) and Exposure at Default (EAD), defined as follows:

- **Probability of Default** is an estimate of the probability that another counter party will not be able to meet its debt obligations.
  In relation to year 2018, the Central Bank has changed the methodology for calculation of expected credit losses, according to which the calculation of probability of default was based on CDS contracts market prices (CDS Spread – Credit Default Swap Spread) (see Note 29.1.1). The reasons for changing the methodology are:
  - expressed volatility of market prices of CDS contracts, whereby it is not possible to clearly distinguish which part of volatility is a consequence of changes in financial instruments issuer credibility on the basis of which CDS contracts are issued,
  - the Central Bank's portfolio structure where exposures are mostly to countries with investible sovereign credit rating level and
  - compliance with the best practices in other central banks.

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.1. Credit risk (continued)

For the impairment calculation, in accordance with best practices in other central banks in region and European Union, which are obliged to comply with IFRS, in year 2019, the Central Bank, as parameter of the probability of default, uses the estimates based on data from transition matrices which are published by credit rating agencies and expert judgement in the form of fixed percentages of probability of default.
For probability of default calculation, the estimates are based on transition matrices for corporations on a global level which contain data on one year transition average rate of long term credit rating level in status "D" i.e. default or status "SD", i.e. selective default. Based on data mentioned above, the probability of default estimates are calculated for exposures to foreign commercial banks and foreign countries, respectively foreign central banks and governments, for which it is possible to calculate composite credit rating.
For probability of default estimates of exposures to foreign countries, respectively foreign central banks and governments, the first non-zero data on one year transition rate of sovereign ratings is taken into account in status "D" i.e. default or status "SD" i.e. selective default from transition matrices for sovereign rating. In year 2018, for exposures for which it was possible to calculate the composite credit ratings, the calculation of probability of default was based on CDS contracts market prices, as a market risk indicator which includes the implicit probability of issuer bankruptcy in a manner in which market evaluates it, and expert judgements of probability of default. For exposures for which the composite credit rating cannot be calculated, in both reporting periods, expert judgements in terms of fixed percentages are used, respectively the simplified approach in accordance with the current situation analysis and former experience.

- **Loss Given Default** is an estimate of the percentage of exposure to the issuer/entity which cannot be collected if a default event occurs. For loss given default, the Central Bank uses constant value of one-year LGD, 45 per cent (45%), in accordance with the article 161. of the Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 (Capital Requirements Regulations i.e. CRR).
- **Exposure at Default** represents the book value of the financial asset, i.e. the carrying amount at the date of the initial recognition/on the reporting date.

For impairment, the Central Bank uses individual and collective approach.

Considering the portfolio structure and classification, the Central Bank will every exposure for which the objective impairment is determined, respectively the default is determined, consider as individually significant exposure and will use the individual estimation approach. For an individual approach to impairment assessment, three different scenarios are used. It is not necessary to determine each possible scenario to measure expected credit losses, but it needs to be taken into the consideration the risk or likelihood of a credit loss occurring in a way that reflects the probability of a credit loss and the probability that there will be no credit loss, even when the probability of credit loss is very low.

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.1. Credit risk (continued)

Impairment amount for exposures that are the subject of individual evaluation approach is calculated as difference between the financial asset carrying amount and probability weighted present value of the estimated cash flows, discounted at the effective interest rate, where the expected credit losses are discounted on reporting date, not on the date of expected default or any other date.

For the purpose of determining a significant increase in credit risk and the recognition of impairment provisions on a collective basis, financial instruments may be grouped on the basis of common credit risk characteristics to facilitate the timely analysis of significant increase in credit risk determination.

Impairment calculation on a collective basis for financial instruments allocated in Stage 1 is carried out on a 12-month basis, while for exposures allocated in Stage 2, the lifetime credit loss is calculated.

Forward-looking information incorporation

The purpose of the impairment is to recognize expected credit losses on a lifetime basis for financial assets that had a significant increase in credit risk compared to initially estimated risks, whether the estimation is on individual or collective basis, taking into account all reasonable and substantiated information including those related to the future. If the reasonable and confirmed information are available without necessary cost or effort, it is not possible to rely solely on past information when the Central Bank is determining if there was a significant increase in credit risk in relation to initial evaluation.

In accordance with the above, incorporation of forward-looking information in expected credit losses calculation is done by adjusting the probability of default.

Given that the Central Bank in its portfolio has financial instruments of issuers that are different by structure as well as by geographical distribution, in relation to incorporating forward looking information in expected credit losses calculation, the Central Bank relies on predicting changes in credit ratings for individual financial instruments, respectively issuers.

Predictions of credit rating movement directions on calculated probability of default of three biggest credit rating agencies: positive, stable or negative outlook, is incorporated in probability of default by the principle of equal probabilities.

29.1.1. Credit risk exposure

The following table shows the reconciliation from the opening to the closing balance of the loss allowance for expected credit losses for financial assets at reporting dates:

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.1. Credit risk (continued)

29.1.1. Credit risk exposure (continued)

In thousands of KM

	2019				2018			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
1. Debt instruments								
As at 1 January - stated	8,993	-	-	8,993	4,290	-	-	4,290
Change in PD calculation at 1 January (Note 11)	(7,704)	-	-	(7,704)	-	-	-	-
As at 1 January - restated	1,289	-	-	1,289	4,290	-	-	4,290
Increases due to change in credit risk	424	-	-	424	22,423	-	-	22,423
Decreases due to change in credit risk	(97)	-	-	(97)	(13,841)	-	-	(13,841)
Decreases due to debt instruments matured	(221)	-	-	(221)	(1,281)	-	-	(1,281)
Net (decrease) / increase during the year	(7,598)	-	-	(7,598)	*7,301*	-	-	*7,301*
Decreases due to debt instruments sold	(52)			(52)	(2,598)	-	-	(2,598)
As at 31 December	1,343	-	-	1,343	8,993	-	-	8,993
2. Deposits with foreign banks								
As at 1 January - stated	2,535	-	-	2,535	1,635	-	-	1,635
Change in PD calculation at 1 January (Note 11)	(2,117)	-	-	(2,117)	-	-	-	-
As at 1 January - restated	418	-	-	418	1,635	-	-	1,635
Increases due to change in credit risk	3,129	-	-	3,129	10,165	-	-	10,165
Decreases due to change in credit risk	(158)	-	-	(158)	(5,202)	-	-	(5,202)
Decreases due to derecognition of term deposits	(2,665)	-	-	(2,665)	(4,063)	-	-	(4,063)
As at 31 December	724	-	-	724	2,535	-	-	2,535

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.1. Credit risk (continued)

29.1.1. Credit risk exposure (continued)

				2019				2018
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
3. Special drawing rights with the IMF								
As at 1 January	-	-	-	-	-	-	-	-
Increases due to change in credit risk	-	-	-	-	3	-	-	3
Decreases due to change in credit risk	-	-	-	-	(3)	-	-	(3)
As at 31 December	-	-	-	-	-	-	-	-
4. Other financial assets								
As at 1 January	5	-	600	605	30	-	600	630
Increases due to change in credit risk	7	-	-	7	39	-	-	39
Decreases due to change in credit risk	(7)	-	-	(7)	(64)	-	-	(64)
As at 31 December	5	-	600	605	5	-	600	605
Total opening balance at 1 January	11,533	-	600	12,133	5,955	-	600	6,555
Total change in PD calculation	(9,821)	-	-	(9,821)	-	-	-	-
Total net increase due to change in credit risk	360	-	-	360	5,578	-	-	5,578
Total closing balance at 31 December	2,072	-	600	2,672	11,533	-	600	12,133

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.1. Credit risk (continued)

29.1.2. Credit risk concentration

a) Maximum exposure to credit risk - financial instruments subject to impairment

The following table shows the maximum exposure to credit risk for the Central Bank's financial assets, analysed by the classes of financial instruments for which the expected credit losses are calculated and recognized:

In thousands of KM	2019				2018			
Classes of financial instruments	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
Foreign currency in cash								
Gross carrying amount	322,599	-	-	322,599	274,099	-	-	274,099
Loss allowance	-	-	-	-	-	-	-	-
Carrying amount	**322,599**	-	-	**322,599**	**274,099**	-	-	**274,099**
Deposits with foreign banks								
Gross carrying amount	3,103,489	-	-	3,103,489	2,913,983	-	-	2,913,983
Loss allowance	(724)	-	-	(724)	(2,535)	-	-	(2,535)
Carrying amount	**3,102,765**	-	-	**3,102,765**	**2,911,448**	-	-	**2,911,448**
Debt instruments								
Gross carrying amount	8,917,413	-	-	8,917,413	8,225,439	-	-	8,225,439
Provisions for expected credit losses (recognized in other comprehensive income)	(1,343)	-	-	(1,343)	(8,993)	-	-	(8,993)
Carrying amount	**8,917,413**	-	-	**8,917,413**	**8,225,439**	-	-	**8,225,439**
Special drawing rights with the IMF								
Gross carrying amount	230	-	-	230	2,236	-	-	2,236
Loss allowance	-	-	-	-	-	-	-	-
Carrying amount	**230**	-	-	**230**	**2,236**	-	-	**2,236**
Other financial assets								
Gross carrying amount	2,827	-	600	3,427	2,693	-	600	3,293
Loss allowance	(5)	-	(600)	(605)	(5)	-	(600)	(605)
Carrying amount	**2,822**	-	-	**2,822**	**2,688**	-	-	**2,688**

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.1. Credit risk (continued)

29.1.2. Credit risk concentration (continued)

b) Maximum exposure to credit risk - financial assets not subject to impairment

In thousands of KM	31 December 2019	31 December 2018
Carrying amounts		
Monetary gold	254,088	209,996
Other investments	27,813	27,813
TOTAL	281,901	237,809

The Central Bank does not hold any collateral or other credit enhancements to cover this credit risk. As at 31 December 2019 the Bank does not have any assets that are past due and does have impaired assets in the amount of KM 600 thousand (31 December 2018: the Central Bank did not have any assets that are past due and had impaired assets in the amount of KM 600 thousand).

Individual credit risk concentration

Deposits with foreign banks in total amounted to KM 3,102,765 thousand as at 31 December 2019 (2018: KM 2,911,448 thousand). The largest portion of these funds is invested in one foreign bank with individual exposure exceeding total equity and reserves of the Central Bank (2018: one foreign bank had individual exposure exceeding total equity and reserves of the Bank).

Individual credit risk concentration exceeding total Central Bank's equity:

31 December 2019			31 December 2018		
Bank rating	In thousands of KM	% of total deposits	Bank rating	In thousands of KM	% of total deposits
AAA	1,104,271	35.59%	AAA	1,457,747	50.07%

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.1. Credit risk (continued)

29.1.2. Credit risk concentration (continued)

Concentration per credit rating

The table below presents an analysis of the Central Bank's concentration per credit rating for its financial assets as at 31 December 2019:

In thousands of KM

31 December 2019

Credit rating	Foreign Currency in Cash	Deposits with foreign banks	Debt instruments	Monetary Gold	Special drawing rights with the IMF	Other financial assets	Other investments	Total
AAA	-	1,842,449	2,190,752	-	-	-	-	4,033,201
AA+	-	-	1,273,212	-	-	-	-	1,273,212
AA	-	78,191	2,977,360	-	-	-	-	3,055,551
AA-	-	-	1,010,563	-	-	-	-	1,010,563
A+	-	547,273	-	-	-	-	-	547,273
A	-	408,740	-	-	-	-	-	408,740
A-	-	-	840,621	-	-	-	-	840,621
II[1]	-	101	-	254,088	230	-	27,813	282,232
BBB+	-	226,011	-	-	-	-	-	226,011
BBB	-	-	624,905	-	-	-	-	624,905
Unrated	322,599	-	-	-	-	2,822	-	325,421
TOTAL	322,599	3,102,765	8,917,413	254,088	230	2,822	27,813	12,627,730

[1] International institutions

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.1. Credit risk (continued)

29.1.2. Credit risk concentration (continued)

The table below presents an analysis of the Central Bank's concentration per credit rating for its financial assets as at 31 December 2018:

In thousands of KM

								31 December 2018
Credit rating	Foreign Currency in Cash	Deposits with foreign banks	Debt instruments	Monetary Gold	Special drawing rights with the IMF	Other financial assets	Other investments	Total
AAA	-	2,414,436	2,072,757	-	-	-	-	4,487,193
AA+	-	-	1,464,686	-	-	-	-	1,464,686
AA	-	78,140	2,211,257	-	-	-	-	2,289,397
AA-	-	-	1,083,041	-	-	-	-	1,083,041
A+	-	-	-	-	-	-	-	-
A	-	408,951	-	-	-	-	-	408,951
A-	-	-	844,614	-	-	-	-	844,614
II[2]	-	1,000	-	209,996	2,236	-	27,813	241,045
BBB+	-	8,921	-	-	-	-	-	8,921
BBB	-	-	549,084	-	-	-	-	549,084
Unrated	274,099	-	-	-	-	2,688	-	276,787
TOTAL	274,099	2,911,448	8,225,439	209,996	2,236	2,688	27,813	11,653,719

[2] International institutions

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.1. Credit risk (continued)

29.1.2. Credit risk concentration (continued)

Geographical concentration of risks of financial assets with credit risk exposure

The following table breaks down the Central Bank's main credit risk exposure at their carrying amounts, as categorized by geographical region as at 31 December 2019 and 2018. For the purposes of this disclosure, the Central Bank has allocated exposures to regions based on the country of domicile of its counterparties:

In thousands of KM	EU countries	Non-EU member countries	Bosnia and Herzegovina	Total
Foreign currency in cash	-	-	322,599	322,599
Deposits with foreign banks	2,618,598	484,167	-	3,102,765
Debt instruments	8,917,413	-	-	8,917,413
Monetary gold	-	254,088	-	254,088
Special drawing rights with the IMF	-	230	-	230
Other financial assets	-	-	2,822	2,822
Other investments	10	27,803	-	27,813
31 December 2019	11,536,021	766,288	325,421	12,627,730

In thousands of KM	EU countries	Non-EU member countries	Bosnia and Herzegovina	Total
Foreign currency in cash	-	-	274,099	274,099
Deposits with foreign banks	2,424,518	486,930		2,911,448
Debt instruments	8,225,439	-	-	8,225,439
Monetary gold	-	209,996	-	209,996
Special drawing rights with the IMF	-	2,236	-	2,236
Other financial assets	-	-	2,688	2,688
Other investments	10	27,803	-	27,813
31 December 2018	10,649,967	726,965	276,787	11,653,719

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.2. Market risk

Market risk is the risk that change of prices on the market, such as interest rates, financial assets prices and foreign exchange rates, will affect the Central Bank's income or the value of investment in financial assets. Basic market risks, which Central Bank follows and manages, are foreign exchange risk and interest rate risk. The objective of market risk management is to manage and control market risk exposures with acceptable parameters, while optimising the return on risk.

For the purpose of quantifying the market risks effect on the currency reserves value, the Central Bank applies the Value at Risk (VaR) concept. VaR represents a statistical measure which shows the maximum loss that can occur in foreign currency reserves portfolio due to the changes in the financial instruments prices and the foreign exchange rates, given a certain level of confidence and a particular time horizon. VaR value for market risk is calculated by analytical (parametric) method, based on the mean value of gain/loss or yield rate of observed portfolio and standard deviation of observed data. The Central Bank, when calculating VaR, applies a level of confidence of 99% and a 10-day horizon.

For calculating VaR value of foreign currency reserves portfolio of the Central Bank, all positions which are exposed to market risks in foreign currency reserves portfolio are taken into account, respectively foreign exchange risk, interest rate risk and price risk. As at 31 December 2019, the exposure of the Central Bank's foreign currency reserves (Value at Risk at a level of confidence of 99% for a 10-day horizon), including fluctuations of the prices of financial instruments and foreign exchange rates against the KM, equals to KM 76,418 thousands (2018: KM 53,655 thousand), or 0,61% of the total financial assets (2018: 0.46% of the total financial assets).

VaR value as at 31 December 2019 and 31 December 2018 is calculated as the sum of componential VaR values:
- for deposits with foreign banks (currency VaR due to changes in foreign exchange rates),
- for debt instruments at fair value through other comprehensive income (interest rate VaR due to changes in market yields, i.e. changes in market prices of debt instruments and
- for monetary gold (VaR due to changes in EUR price of the monetary gold).

In thousands of KM	31 December 2019	31 December 2018
Currency risk	277	362
Interest rate risk	67,443	47,358
Risk of change in EUR price of the monetary gold	8,698	5,935
Total VaR	76,418	53,655

29.2.1. Foreign exchange risk

Foreign exchange risk is the risk of changes in foreign exchange assets and liabilities due to the changes in foreign exchange rates. The Central Bank is exposed to foreign exchange risk through transactions in foreign currencies. Foreign exchange risk is primarily managed through reconciling currency structure of assets and liabilities of the Central Bank, as well as through setting the quantitative limits for exposure to foreign exchange risk.

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.2. Market risk (continued)

29.2.1. Foreign exchange risk (continued)

The control and management of the foreign exchange risk is based on the strict adherence to the provisions of the Law on the Central Bank and the Central Bank's internal regulations.

The largest part of gross foreign currency reserves is held in EUR, and the maximum amount that can be held in convertible currencies other than EUR, must not exceed the equivalent of 50% of the total amount of the unimpaired capital and reserves of the Central Bank.

The Central Bank had the following foreign currency position as at 31 December 2019 and 31 December 2018:

31 December 2019 In thousands of KM	EUR	USD	Other foreign currencies	KM	Total
Foreign currency in cash	322,523	20	56	-	322,599
Deposits with foreign banks	3,092,673	1,880	8,212		3,102,765
Debt instruments	8,917,413	-	-	-	8,917,413
Monetary gold	254,088	-	-	-	254,088
Special drawing rights with the IMF	-	-	230	-	230
Other financial assets	31	-	-	2,791	2,822
Other investments	10	-	-	27,803	27,813
Total financial assets	**12,586,738**	**1,900**	**8,498**	**30,594**	**12,627,730**
Currency in circulation	-	-	-	5,199,916	5,199,916
Deposits from banks	-	-	-	5,743,619	5,743,619
Deposits from the Government and other public depositors	-	-	-	880,675	880,675
Other financial liabilities	1,193	13	-	2,610	3,816
Total financial liabilities	**1,193**	**13**	**-**	**11,826,820**	**11,828,026**
NET FOREIGN EXCHANGE POSITION	12,585,545	1,887	8,498	(11,796,226)	799,704

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.2. Market risk (continued)

29.2.1. Foreign exchange risk (continued)

31 December 2018 In thousands of KM	EUR	USD	Other foreign currencies	KM	Total
Foreign currency in cash	274,025	20	54	-	274,099
Deposits with foreign banks	2,904,946	2,763	3,739	-	2,911,448
Debt instruments	8,225,439	-	-	-	8,225,439
Monetary gold	209,996	-	-	-	209,996
Special drawing rights with the IMF	-	-	2,236	-	2,236
Other financial assets	22	-	-	2,666	2,688
Other investments	10	-	-	27,803	27,813
Total financial assets	11,614,438	2,783	6,029	30,469	11,653,719
Currency in circulation	-	-	-	4,750,614	4,750,614
Deposits from banks	-	-	-	5,523,290	5,523,290
Deposits from the Government and other public depositors	-	-	-	709,367	709,367
Other financial liabilities	586	13	-	2,294	2,893
Total financial liabilities	586	13	-	10,985,565	10,986,164
NET FOREIGN EXCHANGE POSITION	11,613,852	2,770	6,029	(10,955,096)	667,555

The Central Bank is not exposed to EUR foreign currency risk due to Currency Board Arrangement aligning KM to EUR at fixed exchange rate of EUR 1: KM 1.95583.

29.2.2. Interest rate risk

Interest rate risk is the risk of changes in market value of the financial assets due to the adverse movements of interest rates. Interest rate risk is managed by determining the acceptable term duration and maturity of financial instruments in which Central Bank invests. The longer the maturity of financial instruments in which foreign currency reserves are invested, the greater and the associated risk of changes in their market value. Maximum term for investing deposits with foreign banks is one year, while maximum term of investing debt instruments with fixed income is ten years.

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.2. Market risk (continued)

29.2.2. Interest rate risk (continued)

The tables below summarize the Central Bank's exposure to interest rate risk at 31 December 2019 and 31 December 2018:

31 December 2019 In thousands of KM	Up to 3 months	From 3 to 12 months	From 1 to 3 years	Over 3 Years	Non-interest bearing	Total
Foreign currency in cash	-	-	-	-	322,599	322,599
Deposits with foreign banks	2,176,220	927,968	-	-	(1,423)	3,102,765
Debt instruments	1,828,701	7,020,280	-	-	68,432	8,917,413
Monetary gold	-	-	-	-	254,088	254,088
Special drawing rights with the IMF	230	-	-	-	-	230
Other financial assets	10	29	15	-	2,768	2,822
Other investments	-	-	-	-	27,813	27,813
Total financial assets	4,005,161	7,948,277	15	-	674,277	12,627,730
Currency in circulation	-	-	-	-	5,199,916	5,199,916
Deposits from banks	3,014,461	-	-	-	2,729,158	5,743,619
Deposits from the Government and other public depositors	-	-	-	-	880,675	880,675
Other liabilities	-	-	-	-	3,816	3,816
Total financial liabilities	3,014,461	-	-	-	8,813,565	11,828,026
INTEREST RATE GAP	990,700	7,948,277	15	-	(8,139,288)	799,704

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.2. Market risk (continued)

29.2.2. Interest rate risk (continued)

31 December 2018 In thousands of KM	Up to 3 months	From 3 to 12 months	From 1 to 3 years	Over 3 Years	Non-interest bearing	Total
Foreign currency in cash	-	-	-	-	274,099	274,099
Deposits with foreign banks	1,399,725	1,514,118	-	-	(2,395)	2,911,448
Debt instruments	1,879,504	6,273,816	-	-	72,119	8,225,439
Monetary gold	-	-	-	-	209,996	209,996
Special drawing rights with the IMF	2,236	-	-	-	-	2,236
Other financial assets	20	43	59	-	2,566	2,688
Other investments	-	-	-	-	27,813	27,813
Total financial assets	3,281,485	7,787,977	59	-	584,198	11,653,719
Currency in circulation	-	-	-	-	4,750,614	4,750,614
Deposits from banks	3,037,591	-	-	-	2,485,699	5,523,290
Deposits from the Government and other public depositors	-	-	-	-	709,367	709,367
Other liabilities	-	-	-	-	2,893	2,893
Total financial liabilities	3,037,591	-	-	-	7,948,573	10,986,164
INTEREST RATE GAP	243,894	7,787,977	59	-	(7,364,375)	667,555

29.3. Liquidity risk

Liquidity risk refers to the possible difficulties in liquidating a portion of assets quickly, when it is necessary, mostly when market conditions are unfavorable or when there is no opportunity to obtain the appropriate price of the financial asset on financial market.

Liquid assets are defined as those assets whose conversion into cash causes minimal transaction costs and whose value is the closest to market value.

Considering the need of guaranteeing the KM convertibility, the daily liquidity should be provided by the maturity adjustment of the Central Bank foreign currency reserves.

The liquidity framework should match the forecasted potential liquidity needs with identified liquid instruments. The liquidity of each financial instrument eligible for investment must be duly considered before the investment in the instrument is made.

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

29.3. Liquidity risk (continued)

Maturity analysis

Tables below present the financial liabilities of the Central Bank as at 31 December 2019 and 2018 classified into relevant maturity groupings based on the remaining period from the reporting date to the contractual maturity date.

Currency in circulation has been classified in the maturity period within three months.

31 December 2019 In thousands of KM	Up to 3 months	From 3 to 12 months	From 1 to 3 years	Over 3 years	Without specified maturity	Total
Currency in circulation	5,199,916	-	-	-	-	5,199,916
Deposits from banks	5,743,619	-	-	-	-	5,743,619
Deposits from the Government and other public depositors	880,675	-	-	-	-	880,675
Other financial liabilities	3,816	-	-	-		3,816
TOTAL FINANCIAL LIABILITIES	11,828,026	-	-	-	-	11,828,026

31 December 2018 In thousands of KM	Up to 3 months	From 3 to 12 months	From 1 to 3 years	Over 3 years	Without specified maturity	Total
Currency in circulation	4,750,614	-	-	-	-	4,750,614
Deposits from banks	5,523,290	-	-	-	-	5,523,290
Deposits from the Government and other public depositors	709,367	-	-	-	-	709,367
Other financial liabilities	2,893	-	-	-	-	2,893
TOTAL FINANCIAL LIABILITIES	10,986,164	-	-	-	-	10,986,164

30. FAIR VALUE MEASUREMENT OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or liability, the Central Bank takes into account the characteristics of the asset or liability which market participants would take into account when pricing the asset or liability at the measurement date.

The estimated fair values of the Central Bank's financial assets and financial liabilities have been determined using available market information, where it exists, and appropriate valuation methodologies.

In addition, for financial reporting purposes, fair value measurements are categorised into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Central Bank can access at the measurement date;
- Level 2 inputs are inputs, other than quoted prices included in Level 1, that are observable for the asset or liability, either directly or indirectly; and
- Level 3 inputs are unobservable inputs for the asset or liability.

30.1. Financial assets measured at fair value

The following table analyses financial assets measured at fair value at each reporting date, by the level in the fair value hierarchy into which the fair value measurement is categorised. These amounts are based on the values recognised in the statement of financial position.

In thousands of KM

	31 December 2019			
	Level 1	Level 2	Level 3	Total
Financial assets measured at fair value				
Debt instruments	8,917,413	-	-	8,917,413
Monetary gold	254,088	-	-	254,088
TOTAL	9,171,501	-	-	9,171,501

30. FAIR VALUE MEASUREMENT OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES (CONTINUED)

30.1. Financial assets measured at fair value (continued)

In thousands of KM

	31 December 2018			
	Level 1	Level 2	Level 3	Total
Financial assets measured at fair value				
Debt instruments	8,225,439	-	-	8,225,439
Monetary gold	209,996	-	-	209,996
TOTAL	8,435,435	-	-	8,435,435

Financial assets are measured at fair value in statement of financial statement using the quoted bid prices in an active market which correspond to Level 1 hierarchy as at reporting dates.

30.2. Financial assets and financial liabilities not measured at fair value

In thousands of KM

	31 December 2019	
	Carrying amount	Fair value
Financial assets		
Financial assets measured at amortized cost:		
Foreign currency in cash	322,599	322,599
Deposits with foreign banks	3,102,765	3,094,695
Special drawing rights with the IMF	230	230
Other financial assets	2,822	2,822
	3,428,416	*3,420,346*
Financial assets at fair value through other comprehensive income:		
Other investments	27,813	27,813
	27,813	*27,813*
Total	3,456,229	3,448,159
Financial liabilities		
Financial liabilities measured at amortized cost:		
Currency in circulation	5,199,916	5,199,916
Deposits from banks	5,743,619	5,729,302
Deposits from the Government and other public depositors	880,675	878,480
Other financial liabilities	3,816	3,816
Total	11,828,026	11,811,514

30. FAIR VALUE MEASUREMENT OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES (CONTINUED)

30.2. Financial assets and financial liabilities not measured at fair value (continued)

In thousands of KM

	31 December 2018	
	Carrying amount	Fair value
Financial assets		
Financial assets measured at amortized cost:		
Foreign currency in cash	274,099	274,099
Deposits with foreign banks	2,911,448	2,904,460
Special drawing rights with the IMF	2,236	2,236
Other financial assets	2,688	2,688
	3,190,471	*3,183,483*
Financial assets at fair value through other comprehensive income:		
Other investments	27,813	27,813
	27,813	*27,813*
Total	3,218,284	3,211,296
Financial liabilities		
Financial liabilities measured at amortized cost:		
Currency in circulation	4,750,614	4,750,614
Deposits from banks	5,523,290	5,512,943
Deposits from the Government and other public depositors	709,367	708,038
Other financial liabilities	2,893	2,893
Total	10,986,164	10,974,488

The Management considers that the carrying amounts of foreign currency in cash, special drawing rights with the IMF, other financial assets, other investments, currency in circulation and other financial liabilities recognized in the financial statements approximate their fair values as at reporting dates.

As at reporting dates, fair values of financial assets and financial liabilities not measured at fair value are included in Level 2 category and have been determined in accordance with generally accepted pricing models based on a discounted cash flow analysis, with the most significant inputs being the discount rate that reflects the credit risk of counterparties. As discount rate, the Central Bank has used weighted average interest rate on corporate deposits for whole banking market in BH.

31. OFF-BALANCE SHEET ITEMS

The Central Bank maintains certain accounts in foreign currencies related to agreements concluded between the governments in BH and foreign governments and financial organizations. As these accounts do not represent either assets or liabilities of the Central Bank, they have not been included within the Central Bank's statement of financial position.

Off-balance sheet items also include foreign currency accounts of the state institutions and agencies, as well as at commercial banks, for which the Central Bank acts as an agent.

31. OFF-BALANCE SHEET ITEMS (CONTINUED)

Off-balance sheet items consist of:

In thousands of KM	31 December 2019	31 December 2018
Deposits of USAID	2,497	3,042
Deposits of non-residents	**2,497**	**3,042**
Deposits of the Council of Ministers of BH:	10,582	30,964
Deposits of the Council of Ministers of BH on the basis of succession	*46*	*44*
Deposits of the Council of Ministers of BH regarding the servicing of foreign debt	8,641	*9,227*
Deposits of the Council of Ministers of BH regarding the Budget of BH institution	*1,622*	*1,543*
Other deposits of the Council of Ministers of BH	*273*	*20,150*
Deposits of other residents:	15,305	4,048
Deposits - Retirement allowance from Germany	*5*	*12*
Deposit accounts of banks	*15,300*	*4,036*
Deposits of residents	**25,887**	**35,012**
Investments related to securities – Deposit Insurance Agency of BH	70,356	37,499
Investments of residents related to securities	**70,356**	**37,499**
TOTAL	98,740	75,553

USAID Deposits

On the basis of the Agreement regarding financial assistance between BH and the United States of America for the financing of the reconstruction, special interest bearing accounts have been opened. The Central Bank does not charge and does not collect any interest or fees on these accounts.

Residents' investments related to securities

The Central Bank enabled the BH Deposit Insurance Agency to invest in securities by opening cash and custody accounts in the name of the Central Bank and the BH Deposit Insurance Agency. All transactions on the accounts are performed between the BH Deposit Insurance Agency and the Asset Manager. The Central Bank does not charge any interest on such accounts.

BH membership with the IMF

According to arrangements concluded between BH and the IMF signed in December 2002, the Central Bank is designated as a fiscal agent and depository for BH membership with the IMF. The Central Bank's role as a fiscal agent is specific due to "Currency Board" arrangement. The Central Bank acts on behalf of the BH in dealing with the IMF but does not have any responsibility for assets and liabilities related to the membership.

The Central Bank maintains special drawing rights with the IMF account, IMF account No.1 and IMF account No.2 in the statement of financial position. The Central Bank also provides a custody service for the BH Promissory notes issued to support IMF membership and repurchase obligations that are recorded off-balance.

31. OFF-BALANCE SHEET ITEMS (CONTINUED)

Special drawing rights with the IMF are demand funds denominated in SDR on the account opened with the IMF for the BH. The Central Bank holds special drawing rights as a part of its foreign currency reserve management function. These funds are interest-bearing for the Central Bank.

IMF account No. 1 is the IMF account with the Central Bank that is used for transactions with the IMF related to utilization and repayment of IMF loans. IMF account No. 2 is the IMF account with the Central Bank that is used by the IMF for receipts and administrative disbursements in KM. These accounts are part of the Central Bank's liabilities and are expressed in KM.

The quota balance is a specific type of asset which represents BH's subscription as a member of the IMF, denominated in SDRs. The quota represents BH's voting powers in the IMF, the limits to access to financial resources of the IMF and a BH's share in the allocation of SDRs which are the IMF's unit of account.

Promissory notes are issued by the Ministry of Finance and Treasury of BH and are substituted for KM. These securities are payable on demand by the IMF.

SDR allocation is also interest-bearing. Ministry of Finance and Treasury of BH pays interest on special drawing rights allocation.

The Central Bank uses net method in presentation of BH financial position with the IMF which is provided bellow:

In thousands of KM

	31 December 2019	31 December 2018
Quota	641,034	629,809
Special drawing rights with the IMF	230	2,236
TOTAL ASSETS	641,264	632,045
IMF account No.1	1,603	1,575
IMF account No.2	54	53
Securities	945,780	1,042,166
SDR allocation	388,890	382,080
Accrued interest on SDR allocation	506	685
Accounts of payable charges	912	1,601
TOTAL LIABILITIES	1,337,745	1,428,160
BH NET POSITION WITH THE IMF	696,481	796,115

31. OFF-BALANCE SHEET ITEMS (CONTINUED)

As at reporting dates, BH quota with the IMF amounted to SDR 265,200 thousand. The quota does not earn interest.

Promissory notes account, IMF account No.1 and IMF account No. 2 are subject of valuation adjustments whenever the currency is used in financial transactions between the IMF and BH. At least once each year, at the end of the IMF's financial year (30 April), all IMF currency holding are revalued based on the prevailing SDR exchange rate. These valuation adjustments are included in account balances stated.

32. DOMESTIC PAYMENT AND SETTLEMENT SYSTEM

On the basis of the Law on the Central Bank, the Central Bank has established the systems by which interbank payments in convertible marks in BH are performed.

Since January 2001, the interbank clearing and settlement system is organized through two payment systems owned and administered by the Central Bank. Those are Real-Time Gross Settlement (RTGS) and Giro Clearing system (GC).

RTGS is a system through which real-time payment orders are settled through settlement accounts that participants have opened with the Central Bank. All the banks licenced to perform payment operations are participants, as well as the Central Bank. Settlement is final and irrevocable at the moment that settlement account of ordering bank is debited with the same amount that beneficiary's bank settlement account is credited in RTGS. Transactions processed through system are above 10 thousand convertible marks, and its use for lower amounts is optional.

The GC System is an interbank clearing system (bilateral and multilateral) for transactions in the amounts lower or equal to KM 10 thousand. The settlement of net positions of participants in GC is carried out through settlement accounts in RTGS as well as settlement of transactions of legal persons acting as clearing agents, such as card transaction operators. Participants of the system are banks licenced to perform payment operations that are RTGS participants, as well as the Central Bank.

Since June 2019, the system is improved and adjusted to SEPA standard, i.e. ISO 20022. The clearing of payment orders of all the GC participants is carried out by defining the net position of each individual participant as a result of the settlement of all credits and debits of participants for each clearing cycle.

Credit risk

Each participant in the payment systems is obliged to provide funds on its settlement account in RTGS prior to settlement of payment orders.

Pursuant to the role of the Central Bank as defined by the Law on the Central Bank, the Central Bank is not allowed to provide any credits to RTGS and GC System participants which would provide liquidity to the system in any form.

32. DOMESTIC PAYMENT AND SETTLEMENT SYSTEM (CONTINUED)

Operational risk

In order to minimize the operational risk of the smooth functioning of payment systems, Operational Rules for the RTGS and GC System have been issued, as accompanying Decisions setting minimum security standards for the functioning of the system.

Relevant security objectives, policies and procedures aim to ensure security measures and features. The computer systems and the networks are operated according to established objectives and policies. The security objectives and policies are reviewed periodically. Each direct participant is also required to have appropriate security measures and controls for processing payments.

The Central Bank has defined the following Contingency Settlement Procedures:

- Contingency plans and measures: The Central Bank has defined contingency measures in order to ensure continuity of reliable, correct and lawful operation of the payment and settlement systems in the event of disruption to the regular payment and settlement system, or other contingency events.
- Backup system in primary location and DR location: To support the primary location for the payment systems with redundant systems (if case of system falling, switching to another one on the primary location is done), the Central Bank has also established functional DR (Disaster Recovery) system located in Main Bank in Banja Luka.

The systems were available 99.99%, by which was fully performed the Central Bank's legal obligation to enable the orderly and timely functioning of payment transactions in the country.

The Central Bank's management believes that the systems have sufficient capacity to maintain operational reliability.

33. POST-REPORTING DATE EVENTS

The spread of Coronavirus (COVID-19) will affect the business of the Central Bank in the next period. It is not yet possible to estimate the impact of Coronavirus spread and its implications on financial position and performance of the Central Bank.

Except as disclosed above, no adjusting or other non-adjusting events have occurred between the 31 December 2019 and the date of authorization of these financial statements.